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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945 46

No. 892 48

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 26, 1946
CERTIORARI GRANTED MARCH 25, 1946

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INDEX

	Original	Print
Record from D. C. U. S., Eastern District of Pennsylvania	1	1
Docket entries	1	1
Complaint	3	2
Exhibit A—Statement showing date of payment of taxes, month in which sales were made and amounts of taxes	14	8
Exhibit B—Claim for refund	16	9
Exhibit C—Letter rejecting claim for refund	28	17
Exhibit D—Claim for refund [omitted in printing]	29	
Answer	43	17
Stipulation as to amendment to answer	48	20
Amendment to answer	49	20
Agreed Statement of Facts	51	21
Plaintiff's Requests for findings of fact and conclusions of law	87	30
Defendant's Requests for findings of fact and conclusions of law	96	34
Opinion, Kirkpatrick, J., sur pleadings and proof	101	37

Record from D. C. U. S.—Continued	Original	Print
Findings and conclusions	114	45
Judgment	116	45
Certificate of Probable Cause	117	46
Notice of Appeal	118	46
Order of Court extending time for filing record on Appeal [omitted in printing]	119	
Stipulation of counsel waiving filing of second copy of Record on appeal [omitted in printing]	120	
Designation of contents of record on appeal [omitted in printing]	121	
Amended Designation of contents of record on appeal [omitted in printing]	122	
Certificate of clerk [omitted in printing]	123	
Proceedings in U. S. C. C. A., Third Circuit	124	47
Order assigning judge	124	47
Minute entry of argument and submission	125	47
Opinion, Goodrich, J.	126	48
Judgment	137	55
Clerk's certificate [omitted in printing]	138	56
Order allowing certiorari	139	56
Stipulation as to printed record	140	56

1 In United States District Court for the Eastern District of Pennsylvania

Civil Action No. 3299

THE ELECTRIC STORAGE BATTERY COMPANY

v.

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

Hepburn & Norris, Esqs. Gerald A. Gleeson, Esq.

Docket entries

July 20, 1943—Complaint, filed.
July 20, 1943—Summons exit.
July 30, 1943—Appearance of Gerald A. Gleeson, Esq., for defendant, filed.
Aug. 11, 1943—Summons returned: "on July 20, 1943, served W. J. Rothensies and G. A. Gleeson, U. S. Atty." and "on July 20, 1943, served U. S. Atty. General and Commissioner of Internal Revenue by registered mail" and filed.
Aug. 11, 1943—Stipulation of counsel extending time for filing answer to November 17, 1943, and Order of Court approving same, filed. Noted 8/12/43.
Nov. 16, 1943—Stipulation of counsel extending time for filing answer to January 16, 1944, and Order of Court approving same, filed. Noted 11/17/43.
Dec. 15, 1943—Answer, filed.
Dec. 17, 1943—Order to place case on the Trial List, filed.
June 5, 1944—Trial—Witnesses sworn.
June 28, 1944—Testimony filed (2 Vol.).
Aug. 2, 1944—Plaintiff's requests for findings of fact and conclusions of law, filed.
Aug. 2, 1944—Argument sur P. & P. submitted on briefs. C. A. V.
Aug. 9, 1944—Defendant's requests for findings of fact and conclusions of law, filed.
2 Oct. 30, 1944—Opinion, Kirkpatrick, J., granting judgment for plaintiff, filed.
Oct. 30, 1944—Judgment in favor of plaintiff in sum of $229,805.34 with interest and costs, filed. 10/31/44 Noted & notice mailed.
Nov. 3, 1944—Certificate of Probable Cause, filed.

Nov. 29, 1944—Stipulation of counsel as to amendment to the answer, filed.
Nov. 29, 1944—Amendment to answer, filed.
Nov. 29, 1944—Agreed statement of facts, filed.
Jan. 26, 1945—Defendant's notice of Appeal, filed. 1/27/45 Copy to Hepburn & Norris.
Jan. 26, 1945—Copy of Clerk's Notice to U. S. Circuit Court of Appeals, filed.
Feb. 7, 1945—Designation of contents of record on appeal, filed.
Feb. 12, 1945—Order of Court extending time for filing record on appeal to Apr. 26, 1945. filed. 2/13/45 Noted & notice mailed.
Mar. 13, 1945—Amended designation of contents of record on appeal, filed.
Mar. 27, 1945—Stipulation of counsel as to filing one copy of record on appeal, filed.

3 In United States District Court

Title omitted.

Complaint

Filed July 20, 1943

This suit is brought by the plaintiff, The Electric Storage Battery Company, a corporation, against the defendant, Walter J. Rothensies, individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, to recover the sum of Two Hundred and Twenty-nine Thousand, Eight Hundred and Five Dollars and Thirty-four Cents ($229,805.34), with interest, as hereinafter set forth, upon the cause of action of which the following is a statement.

For a first count and cause of action, plaintiff alleges as follows:

1. The plaintiff is a corporation organized and existing under the laws of the State of New Jersey, and during the times hereinafter mentioned maintained its principal office at Nineteenth Street and Allegheny Avenue, in the City and County of Philadelphia, Commonwealth of Pennsylvania.

4 2. The defendant was, at the time of the collections hereinafter mentioned, and still is, the United States Collector of Internal Revenue for the First District of Pennsylvania, which Internal Revenue District is situated in the Eastern District of Pennsylvania, of which District the defendant is a resident.

3. This is a proceeding of a civil nature for the recovery of an internal revenue tax erroneously and illegally assessed and col-

lected under the internal revenue laws, and the amount in controversy, exclusive of interest and costs, is the sum or value of Two Hundred and Twenty-nine Thousand, Eight Hundred and Five Dollars and Thirty-four Cents ($229,805.34).

4. The books of the plaintiff are kept on the accrual basis and its income tax returns and excess profits tax returns for all years referred to herein were prepared and filed on the accrual basis.

5. Each of the plaintiff's income tax returns and excess profits tax returns referred to herein has been audited and examined by the Bureau of Internal Revenue. The accrual basis of reporting income and deductions for all years referred to herein has been accepted by the Bureau of Internal Revenue as the method of accounting correctly reflecting net income.

6. In each calendar year during the period beginning February 25, 1919 and ending on February 28, 1926, the plaintiff made sales of portable electric storage batteries, all of which sales were made to persons other than manufacturers of automobile trucks, automobile wagons, automobiles or motor cycles, and on or before the last day of the calendar month then immediately succeeding each of the said months in which the said sales were made, in accordance with the requirements and upon the demand of the Collector of Internal Revenue for the First District of Pennsylvania, made a return in accordance with the provision of Section 900 of the United States Revenue Acts of 1918 and 1921, and of Section 600 of the United States Revenue Act of 1924, of the computation of manufacturer's exercise taxes at the rate of five per centum under the 1918 and 1921 Acts and two and one-half per centum under the 1924 Act, of the selling prices of the said portable electric storage batteries upon sales thereof made by the plaintiff in each immediately preceding calendar month. There is attached hereto, marked "Exhibit A", and made a part hereof, a statement consisting of three columns which sets forth in Column 1, the date of payment of the said taxes, in Column 2, the calendar month in which the sales were made, upon which the said taxes were based respectively, and in Column 3, the amounts of taxes which were paid upon the selling prices of the storage batteries sold during the said calendar months respectively, which amounts were not added separately on the invoices of the plaintiff to the purchasers of the said batteries, and which amounts were absorbed and paid by the plaintiff and were not passed on for payment to the said purchasers or any of them. The total amount of such taxes so paid by the plaintiff upon the demand of the Collector of Internal Revenue as aforesaid, as set forth in Column 3 of said Exhibit "A", is as follows:

Based on sales in the period from February 25, 1919 to May 31, 1922, not refunded to plaintiff	$912,978.57
Based on sales in the period from June 1, 1922 to February 28, 1926, refunded to plaintiff as stated in paragraph 9 hereof	825,151.52
Total	1,738,130.09

7. The amounts of the excise taxes paid as aforesaid by the plaintiff upon demand by the Collector of Internal Revenue, and after protest filed against such payment, were shown as a deduction from income on plaintiff's income tax returns for the respective years from 1919 to 1926, inclusive, the years in which such deductions would be applicable if the assessment of such excise taxes was not erroneous and illegal.

8. Suit for the collection of said sum of $825,151.52, as taxes paid under protest and erroneously and illegally collected, was entered by the plaintiff herein against Blakely D. McCaughn, individually and as Collector of Internal Revenue, as at June Term, 1928, No. 14008, at law, in the United States District Court in and for the Eastern District of Pennsylvania, and after due proceedings, judgment in favor of the plaintiff was entered and became final on May 1, 1933.

9. Thereafter, on October 15, 1935, the United States paid to the plaintiff the said amount of $825,151.52, plus interest of $570,363.83, in accordance with the said judgment.

10. On or about January 9, 1937, a Revenue Agent's
7 report covering an examination of the plaintiff's income tax return for the year 1935 was filed recommending the inclusion in the plaintiff's taxable income for the year 1935 of the amount of the refund of tax, $825,151.52, and interest thereon of $570,363.83, and in accordance therewith, on or about November 22, 1938, the plaintiff received from the defendant herein the Treasury Department form entitled "Notice and Demand for Income Tax", requiring payment of taxes as follows:

Additional income tax claimed for the year 1935	$188,140.56
Interest on above to November 18, 1938	30,195.27
Additional excess profits tax claimed for the year 1935	9,883.31
Interest on above to November 18, 1938	1,586.20
Total	229,805.34

11. The payment of the said income taxes and excess profits taxes, and interest, in the total amount of $229,805.34 was made by plaintiff on or about December 5, 1938 to the defendant herein, the Collector of Internal Revenue for the First District of Pennsylvania. This payment was made under protest and with notice to the Collector that refund of the payment would be claimed.

12. The plaintiff, on or about the 30th day of November, 1940, filed with the defendant, the Collector of Internal Revenue of the United States for the First District of Pennsylvania, a Claim for refund in the amount of $229,805.34. A true and correct copy of said Claim for Refund is attached hereto, made a part hereof, and marked "Exhibit B".

8

13. The said Claim for Refund, in amount of $229,805.34, was disallowed in full by the Commissioner of Internal Revenue of the United States, by a registered letter dated July 25, 1941, a true and correct copy of which is attached hereto and made a part hereof, and marked "Exhibit C".

14. The refund to the claimant by the United States of excise taxes in amount of $825,151.52, paid on or about October 15, 1935, did not accrue during the year 1935, which is the year for which additional income and excess profits taxes here in dispute were assessed.

15. The plaintiff being on an accrual basis avers that the inclusion in its income for the year 1935 of the amount of the cash payment refunding manufacturer's excise taxes and interest applicable to the years 1922 to 1926 as aforesaid, was erroneous and illegal; that the said payment did not constitute income for the year 1935, subject to the tax under the Sixteenth Amendment to the Constitution of the United States or the Acts of Congress, and that the said payment constituted a return of capital to plaintiff.

16. Prior to making the payments of excise tax as aforesaid, plaintiff protested that the assessment against the plaintiff of said excise taxes under said Acts was erroneous and illegal. On July 19, 1926 the plaintiff duly filed with the Collector of Internal Revenue for the First District of Pennsylvania a Claim for Refund of the said manufacturer's excise taxes erroneously and illegally collected from the plaintiff during the period from June 1, 1922 to February 28, 1926, in amount of $825,151.52, a copy of which Claim for Refund is attached hereto as "Exhibit D."

9

Prior to the filing and auditing of plaintiff's income tax returns for the years 1922 to 1926, inclusive, the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania were given notice of the fact that plaintiff protested against the collection from it of the said payments of manufacturer's excise taxes as described above, and of the fact that collection of said payments as taxes from plaintiff was erroneous and illegal, and the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania thereupon had full opportunity to include the amounts of said payments of taxes in the plaintiff's income for the years 1922 to 1926, inclusive.

17. The payment to the plaintiff by the United States of interest on excise taxes on or about October 15, 1935, in the amount of $570,363.83 (except as to the amount of $36,351.88 thereof, which represented interest earned in and accruable for the period from January 1, 1935 up to the date of payment, October 15, 1935), did not constitute income for the year 1935, subject to tax under the Sixteenth Amendment to the Constitution of the United States, or the Acts of Congress; did not accrue during the year 1935; was not earned during the year 1935, and was not applicable to the year 1935.

18. Prior to the filing and auditing of plaintiff's income tax returns for the years 1922 to 1934, inclusive, the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania were given notice of the fact that plaintiff protested against the collection from it of the said payments of manufacturer's excise taxes as described above,
10 and of the fact that collection of said payments as taxes from plaintiff was erroneous and illegal, and the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania thereupon had full opportunity to include in plaintiff's income for each of the said years the amount of the interest earned in and accruable for each of said years respectively, and applicable to each of the said years respectively.

19. The inclusion in the plaintiff's taxable income for the year 1935 of the amount of the refund of manufacturer's excise taxes and interest as described above, is not good accounting practice, is not in accordance with the accrual theory, and produces a distortion of plaintiff's income for the said year.

For a second count and cause of action plaintiff repeats the allegations of paragraphs numbered 1 to 19 inclusive, and in addition alleges:

20. During the period from April 28, 1919, until June 30, 1922, excise taxes as described in paragraph 6 of this Complaint for each month during the entire period, were paid to the Collector of Internal Revenue for the First District of Pennsylvania at Philadelphia, and the total amount of said excise taxes on portable electric storage batteries for the period from April 1, 1919 to May 31, 1922 was $912,978.57, and said excise taxes so paid, as aforesaid on portable electric storage batteries were illegally assessed and collected. Said amount of taxes so paid for
11 the period from April 1, 1919 to May 31, 1922 was not legally refundable to plaintiff by reason of the fact that

the Statute of Limitations intervened as a bar against the filing of Claim for Refund therefor.

21. It is the right of the plaintiff to have set off against the amount of additional income tax and excess profits tax assessed against plaintiff for the year 1935 or which may be claimed to be due from plaintiff for any year prior to 1935 on account of the payment to plaintiff of the refund of excise tax on its portable electric storage batteries, the amount of excise tax on its portable electric storage batteries paid by plaintiff for the period from February 25, 1919 to June 30, 1922, which excise taxes for the said period from February 25, 1919 to June 30, 1922 were illegally assessed and collected, but have not been refunded, to the plaintiff, as hereinbefore set forth. Against any deficiency for income tax on the amount of such excise taxes, as actually were refunded to plaintiff, the plaintiff is entitled to recoup the amounts of excise taxes illegally exacted, the refund of which to plaintiff was barred by the Statute of Limitations. The said set-off and recoupment claim, and any such income tax deficiency had a common origin in the erroneous application of the Excise Tax Act.

The following paragraphs apply to both the first and second counts and causes of action:

22. The defendant, individually, and as Collector of Internal Revenue for the First District of Pennsylvania, was and is without authority under the Acts of Congress, or otherwise, to demand, collect and receive the aforesaid sum of $229,805.34
12 paid by plaintiff to defendant, and said sum was erroneously and illegally demanded, collected and received by the defendant from the plaintiff, and was not due from the plaintiff to the defendant at the time said sum was collected and received by the defendant, or at any other time, either before or since that date.

23. No part of said sum of $229,805.34 has been remitted, refunded, or repaid to the plaintiff or to any person or corporation on its account by the defendant.

Wherefore, plaintiff demands judgment against the defendant for the said sum of $229,805.34, together with interest thereon, according to law, and the costs and disbursements of this action.

(Sgd.) CHARLES C. NORRIS, Jr.,
(Sgd.) PHILIP DECHERT,
Office and Post-office address,
1500 Walnut Street, Philadelphia 2, Pennsylvania,
Attorneys for Plaintiff.

13 [*Duly sworn to by H. C. Allan; jurat omitted in printing.*]

14 *Exhibit A to complaint*

Date of payment of the excise taxes	Calendar month in which the sales were made upon which the said taxes were based respectively	The amounts of taxes paid
April 28, 1919	March 1919	$15,163.69
July 18, 1919	April 1919	8,385.58
July 18, 1919	May 1919	20,313.82
July 31, 1919	June 1919	19,089.39
August 27, 1919	July 1919	22,462.81
September 30, 1919	August 1919	22,181.21
October 31, 1919	September 1919	22,505.09
November 29, 1919	October 1919	24,785.40
December 31, 1919	November 1919	24,362.78
January 31, 1920	December 1919	27,309.85
February 28, 1920	January 1920	23,078.43
March 31, 1920	February 1920	19,872.40
April 30, 1920	March 1920	31,070.04
May 29, 1920	April 1920	30,935.33
June 30, 1920	May 1920	31,290.22
July 29, 1920	June 1920	27,629.48
August 31, 1920	July 1920	27,485.81
September 30, 1920	August 1920	23,384.98
October 29, 1920	September 1920	28,068.01
November 30, 1920	October 1920	23,556.89
December 31, 1920	November 1920	22,759.81
January 31, 1921	December 1920	16,551.52
February 29, 1921	January 1921	17,598.41
March 31, 1921	February 1921	18,690.13
April 30, 1921	March 1921	34,113.84
May 31, 1921	April 1921	28,535.80
June 30, 1921	May 1921	22,318.85
July 28, 1921	June 1921	20,336.72
August 30, 1921	July 1921	22,757.61
September 30, 1921	August 1921	24,351.97
October 31, 1921	September 1921	28,433.69
November 30, 1921	October 1921	35,709.36
December 30, 1921	November 1921	24,568.49
January 30, 1922	December 1921	20,817.98
February 25, 1922	January 1922	18,252.38
March 27, 1922	February 1922	17,767.29
April 27, 1922	March 1922	20,814.38
May 25, 1922	April 1922	26,860.64
June 27, 1922	May 1922	22,154.48
(Subtotal of taxes paid based on sales up to May 31, 1922)		912,978.57
July 31, 1922	June 1922	16,888.40
September 1, 1922	July 1922	17,435.60
October 2, 1922	August 1922	21,913.09
November 1, 1922	September 1922	24,511.93
December 1, 1922	October 1922	26,138.58
January 2, 1923	November 1922	22,866.90
February 1, 1923	December 1922	23,131.76
March 1, 1923	January 1923	18,952.99
Carried forward		171,839.84
April 2, 1923	February 1923	15,648.86
May 2, 1923	March 1923	23,135.86
June 1, 1923	April 1923	26,178.70
July 2, 1923	May 1923	18,930.28
August 2, 1923	June 1923	16,820.53
September 1, 1923	July 1923	18,178.64
October 1, 1923	August 1923	24,550.45
November 1, 1923	September 1923	29,718.66
December 3, 1923	October 1923	32,022.12
January 2, 1924	November 1923	27,932.39
February 1, 1924	December 1923	20,790.26
March 1, 1924	January 1924	25,819.47
April 1, 1924	February 1924	20,709.41
May 1, 1924	March 1924	23,512.71
June 3, 1924	April 1924	24,716.03
July 1, 1924	May 1924	16,960.60
August 1, 1924	June 1924	16,077.53
September 3, 1924	July 1924	10,853.89
October 1, 1924	August 1924	11,847.48
November 1, 1924	September 1924	14,823.45
December 2, 1924	October 1924	15,968.89

Date of payment of the excise taxes	Calendar month in which the sales were made upon which the said taxes were based respectively	The amounts of taxes paid
January 2, 1925	November 1924	15,027.65
February 2, 1925	December 1924	17,584.40
March 2, 1925	January 1925	13,263.06
April 1, 1925	February 1925	9,692.25
May 2, 1925	March 1925	11,281.36
June 3, 1925	April 1925	9,762.37
July 1, 1925	May 1925	10,089.95
August 3, 1925	June 1925	9,253.81
September 2, 1925	July 1925	12,951.86
October 1, 1925	August 1925	13,808.32
November 4, 1925	September 1925	17,658.98
December 1, 1925	October 1925	22,155.49
January 2, 1926	November 1925	18,134.45
February 2, 1926	December 1925	16,972.81
March 2, 1926	January 1926	13,182.24
April 3, 1926	February 1926	7,591.46
(Subtotal of taxes paid based on sales in the period from June 1, 1922 to February 28, 1926).		825,151.52
Grand total of taxes paid		1,738,280.09

16 *Exhibit "B" to complaint*

CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

Collector's stamp (date received), received No. 30, 1940, 1st Dist. Penna.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☒ Refund of tax illegally collected.

☐ Refund of amount paid for stamps unused, or used in error or excess.

☐ Abatement of tax assessed (not applicable to estate or income taxes).

STATE OF PENNSYLVANIA,

County of Philadelphia, ss:

Name of taxpayer or purchaser of stamps: Electric Storage Battery Company; business address, 19th and Allegheny Avenues, Philadelphia, Pennsylvania; residence: —.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: First District of Pennsylvania.

2. Period (if for income tax, make separate form for each taxable year) from January 1, 1935, to December 31, 1935.

3. Character of assessment or tax: Additional Federal Corporation Income Tax and Excess Profits Tax.

4. Amount of assessment: $229,805.34; dates of payment: December 3, 1938.

5. Date stamps were purchased from the Government: —.

6. Amount to be refunded: $229,805.34.

7. Amount to be abated (not applicable to income or estate taxes): —.

8. The time within which this claim may be legally filed expires, under Section 322 of the Revenue Act of 1938, on December 3, 1940.

The deponent verily believes that this claim should be allowed for the following reasons:

See statement attached, which is made a part hereof.

[CORPORATE SEAL] ELECTRIC STORAGE BATTERY COMPANY.
(Sgd.) R. C. NORBERG.

Sworn to and subscribed before me this 29th day of November 1940.

[NOTARIAL SEAL] (Sgd.) EARL W. WILLIAMS,
Notary Public.

17 STATEMENT TO ACCOMPANY CLAIM FOR REFUND OF THE ELECTRIC STORAGE BATTERY COMPANY FOR ADDITIONAL INCOME TAX ILLEGALLY ASSESSED AGAINST AND COLLECTED FROM SAID COMPANY FOR THE CALENDAR YEAR 1935

The Electric Storage Battery Company (herein called the "claimant") is a corporation organized and existing under the laws of the State of New Jersey and maintaining manufacturing plant and principal place of business at Allegheny Avenue and 19th Street, in the City of Philadelphia, Commonwealth of Pennsylvania. The books of the claimant are kept on the accrual basis and its income tax returns for all years referred to herein were prepared and filed on the accrual basis. Each of said returns has been carefully audited by the Bureau of Internal Revenue.

In each calendar year during the period beginning June 1, 1922, and ending on February 28, 1926, the claimant made sales of portable electric storage batteries, all of which sales were made to persons other than manufacturers of automobile trucks, automobile wagons, automobiles or motorcycles, and on or before the last day of the calendar month then immediately succeeding each of the said months in which the said sales were made, in accordance with the requirements and upon the demand of Blakely D. McCaughn, Collector of Internal Revenue for the First District of Pennsylvania, made a return in accordance with the provisions of Title IX, § 900, of the United States Revenue Act of 1921, and of Title VI. § 600, of the United States Revenue Act of 1924, of

the computation of manufacturer's excise taxes at the rate of five per centum under the 1921 Act and two and one-half per centum under the 1924 Act, of the selling prices of the said portable electric storage batteries upon sales thereof made
18 by the claimant in each immediately preceding calendar month. The total taxes so paid during the said period amounted in the aggregate to the sum of $973,532.57. There is attached hereto, marked "Exhibit A" and made a part hereof a statement consisting of five columns which sets forth in Column 1, the date of payment of the said taxes, in Column 2, the calendar month in which the sales were made upon which the said taxes were based respectively, in Column 3, the amount of taxes paid upon the selling prices of the storage batteries sold during the said calendar months respectively, in Column 4, the amount of the said taxes which were added separately on the invoices of the claimant to the purchasers of the said storage batteries, and for which the claimant was therefore reimbursed, and in Column 5, the amounts of the said taxes which were not added separately on the invoices of the claimant to the purchasers of the said batteries, which sums were absorbed and paid by the claimant and were not passed on for payment to the said purchasers or any of them. The total amount of the taxes paid by the claimant upon the demand of the Collector of Internal Revenue as aforesaid, as set forth in Column 5 of said Exhibit "A" is $825,151.52, and the total amount of the taxes paid by the claimant upon the demand of the Collector of Internal Revenue, as aforesaid, as set forth in Column 4 of said Exhibit "A" is $148,381.05.

Prior to making the payments as aforesaid claimant protested by telegram, by letter, and verbally that the assessment of taxes under said acts against the claimant was erroneous and illegal.

On July 19, 1926, the claimant duly filed with the Commissioner of Internal Revenue of the United States a Claim for Refund of the said manufacturer's excise taxes erroneously and illegally collected from the claimant during the period specified above.

On June 28, 1928, the claimant filed suit in the District
19 Court of the United States for the Eastern District of Pennsylvania against Blakely D. McCaughn, formerly Collector of Internal Revenue, Docket No. 14008, At Law, June Term, 1928. On April 28, 1931, an opinion was filed by Judge Kirkpatrick granting judgment in favor of claimant and on October 13, 1931, judgment was entered in favor of the claimant.

On November 10, 1931, an appeal was filed by the defendant in this case to the United States Circuit Court of Appeals for the Third Circuit, which appeal was docketed in the said Circuit Court as March Term, 1932, No. 4752. On January 31, 1933, an opinion was filed by the said Circuit Court affirming the judgment of the

District Court, and on May 2, 1933, the mandate was issued by the said Circuit Court to the said District Court affirming the judgment of the District Court in favor of the claimant. Said judgment in favor of the claimant therefore became final on May 1, 1933.

After the filing of the said mandate and the entry of final judgment in favor of the claimant there was not any dispute at any time as to the right of the claimant to collect in full from the United States the said amount of $825,151.52, representing tax paid by claimant and not added to the invoices to the purchasers.

Thereafter, on October 15, 1935, the United States paid to the claimant the said amount of $825,151.52 plus interest of $570,363.83 in accordance with the said judgment.

The official records of the United States District Court for the Eastern District of Pennsylvania, Docket No. 14008, and the United States Circuit Court of Appeals for the Third Circuit, Docket No. 4752, in this case are specifically referred to herein and are included herein by reference. The Decision of the District Court is reported in 52 Federal (2nd) 205 and the decision of the Circuit Court of Appeals is reported in 63 Federal (2nd) 715.

20 On or about January 9, 1937, a Revenue Agent's report covering an examination of the claimant's income tax return for the year 1935 was filed recommending the inclusion in the claimant's taxable income for the year 1935 of the amount of the refund of tax, $825,151.52, and interest of $570,363.83. Subsequently, on or about November 22, 1938, the claimant received Treasury Department Form No. 7658—"Notice and Demand for Income Tax", requiring the payment of taxes as follows:

Additional income tax claimed for the year 1935	$188,140.56
Interest on above to November 18, 1938	30,195.27
Additional excess profits tax claimed for the year 1935	9,883.31
Interest on above to November 18, 1938	1,586.20
	229,805.34

The payment of the said income taxes and excess profits taxes, and interest, in the total amount of $229,805.34, was made by claimant on December 3, 1938, to the Collector of Internal Revenue for the First District of Pennsylvania. This payment was made under protest and with notice to the Collector that refund of the payment would be claimed. This claim is for refund of the said income taxes, excess profits taxes, and interest so paid, and for interest on the amount of the payment according to law.

The claimant believes that the inclusion in its taxable income for the year 1935 of the amount of the refund of manufacturer's excise taxes and interest as described above, was erroneous and illegal.

The refund to the claimant by the United States of excise taxes in amount of $825,151.52, paid on or about October 15, 1935, did not constitute income subject to tax under the Sixteenth
21 Amendment to the Constitution to the United States or the Acts of Congress.

The refund to the claimant by the United States of excise taxes in amount of $825,151.52, paid on or about October 15, 1935, constituted a return of capital.

The refund to the claimant by the United States of excise taxes in amount of $825,151.52, paid on or about October 15, 1935, did not accrue during the year 1935 which is the year here in dispute.

Prior to the filing and auditing of claimant's income tax returns for the years 1922 to 1926, inclusive, the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania were given notice of the fact that claimant protested against the collection from it of the said manufacturer's excise taxes as described above and of the fact that collection of said taxes from claimant was illegal, and the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania thereupon had full opportunity to include the amounts of said taxes in the claimant's income for the years 1922 to 1926, inclusive.

The payment to the claimant by the United States of interest on excise taxes on or about October 15, 1935, in the amount of $570,363.83, did not constitute income subject to tax under the Sixteenth Amendment to the Constitution of the United States, or the Acts of Congress.

The payment to the claimant by the United States of interest on excise taxes on or about October 15, 1935, in the amount of $570,363.83, did not accrue during the year 1935.

The payment to the claimant by the United States of interest on excise taxes on or about October 15, 1935, in the amount of $570,-363.83, was not a payment for interest earned during the year 1935 nor applicable thereto (except as to the amount of interest earned from January 1, 1935, up to the date of payment—October 15, 1935).

22 Prior to the filing and auditing of claimant's income tax returns for the years 1922 to 1934, inclusive, the Commissioner of Internal Revenue and the Collector of Internal Revenue for the First District of Pennsylvania were given notice of the fact that claimant protested against the collection from it of the said manufacturer's excise taxes as described above, and of the fact that collection of said taxes from claimant was illegal and the Commissioner of Internal Revenue and/or the Collector of Internal Revenue for the First District of Pennsylvania thereupon had full opportunity to include in claimant's income for

each of the said years the amount of the interest earned during each of said years respectively, and applicable to each of the said years respectively.

The inclusion in the claimant's taxable income for the year 1935 of the amount of the refund of manufacturer's excise taxes and interest as described above, is not good accounting practice, is not in accordance with the accrual theory, and produces a distortion of claimant's income for the said year.

The inclusion in the claimant's taxable income for the year 1935 of the amount of the refund of manufacturer's excise taxes and interest as described above, is not in accordance with the regulations and rulings of the Bureau of Internal Revenue which were in effect at the time and produces an unfair result to the claimant. The exact amount of the refund to the penny was always fixed and definite from the time when the manufacturer's excise taxes were originally paid (the years 1922 to 1926 inclusive). The amount of the refund of the said manufacturer's excise taxes and the right to the refund became fixed and definite long before 1935. The judgment became final in 1933, and thereafter could not have been collaterally attacked in any way.

It is improper accounting and contrary to the accrual theory to treat an item as income or as a deduction in one year, when the amount thereof and all rights with respect thereto have become fixed and definite in a prior year, as in this case.

23 The inclusion in the claimant's taxable income for the year 1935 of the amount of the refund of manufacturer's excise tax and interest as described above is contrary to the Constitution, and the Internal Revenue laws of the United States, and to the rulings and regulations of the Bureau of Internal Revenue. The claimant therefore believes that the additional income tax and excess profits tax paid by claimant for the year 1935 as described above, should be refunded.

24 SUPPLEMENTARY STATEMENT TO ACCOMPANY CLAIM FOR REFUND OF THE ELECTRIC STORAGE BATTERY COMPANY FOR ADDITIONAL INCOME TAX ILLEGALLY ASSESSED AND COLLECTED FROM SAID COMPANY FOR THE CALENDAR YEAR 1935, FILED NOVEMBER 30, 1940

In the official Record in the United States District Court for the Eastern District of Pennsylvania in case entitled The Electric Storage Battery Company, a corporation, Plaintiff, vs. Blakely D. McCaughn, formerly Collector of Internal Revenue of the United States for the First District of Pennsylvania, Defendant, June Term, 1938, Docket No. 14008, and in the Record in the United States Circuit Court of Appeals for the Third Circuit in the case of Blakely D. McCaughn, formerly Collector of Internal

Revenue, Appellant vs. The Electric Storage Battery Company, Appellee, March Term, 1932. Docket No. 4752, both of which Records are included by reference in this Claim, there is set forth, as a part of the Claim for Refund, a copy of a letter from The Electric Storage Battery Company to "Treasury Department, Commissioner of Internal Revenue, Washington, D. C., ST-WED, R. M. Estes, Deputy Commissioner" dated November 14, 1924, which sets forth the reasons for the claim that the portable storage batteries in question were not subjected to the excise taxes which had been assessed upon the sales thereof. The first payment of said taxes was made April 28, 1919, for the period from February 25, 1919 to March 31, 1919, both inclusive, upon gross sales subject to tax during the said period of $303,273.72, the said payment of tax on April 28, 1919 being in the amount of $15,163.69. Thereafter, during the period from April 28, 1919, until June 30, 1922, said excise taxes for each month during the entire period were paid to the Collector of Internal Revenue for the First District of Pennsylvania at Philadelphia, and the total amount of said taxes for the period beginning April 1, 1919 to May 31 1922
25 exceeded the sum of $229,805.34, and said taxes so paid as aforesaid were illegally assessed and collected, as decided in the Opinions and Judgments of the United States District Court for the Eastern District of Pennsylvania and the United States Circuit Court of Appeals for the Third Circuit, referred to above. However, said amount of taxes was not legally refundable to The Electric Storage Battery Company by reason of the fact that the Statute of Limitations intervened as a bar against the filing of Claim for Refund therefor.

Under the decision of the United States Circuit Court of Appeals for the Sixth Circuit in Dixie Margerine Co., Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 8204, it is held that in connection with a refund of illegally collected taxes, where similar taxes were unrefunded because of the Statute of Limitations, against the deficiency for income tax on the amount of such taxes as actually were refunded, the taxpayer is entitled to recoup the amounts of excise tax illegally exacted, the refund of which was barred by the Statute of Limitations. The recoupment claim and the deficiency assessment had a common origin in the erroneous application of the Act. See similar contentions in Bull vs. United States, 295 U. S. 247; Crosset Lumber Co. vs. United States 87 Fed. (2d) 930; Stone vs. White, 301 U. S. 532 and Peterson vs. Feyereisen, 203 Wis. 294.

In connection with 1935 income tax of The Electric Storage Battery Company, the Commissioner of Internal Revenue should set off against the amount of additional income tax claimed for the

said year, on account of the refund of excise tax on portable storage batteries, the amount of excise tax on similar portable electric storage batteries paid for the period from February 25, 1919 to June 30, 1922, which excise taxes for the said period were illegally assessed and collected, but have not been refunded, to the claimant herein, The Electric Storage Battery Company.

26 The excise taxes referred to above were alleged by the Commissioner of Internal Revenue to be due under Section 900, sub-section (3) of the Revenue Act of 1918, Title IX, Section 900, Sub-section (3) of the Revenue Act of 1921 and Title VI, Section 600, sub-section (3) of the Revenue Act of 1924.

27 *Exhibit A*

I Date paid as per collector's endorsements on checks	II Month in which sales made	III Amount of taxes paid	IV Amount of tax added to invoice to purchaser	V Amount of tax not added to invoice to purchaser
July 31, 1922	June 1922	$20,750.15	$3,861.75	$16,888.40
September 1, 1922	July 1922	20,904.09	3,528.49	17,435.60
October 2, 1922	August 1922	25,262.34	3,348.65	21,913.69
November 1, 1922	September 1922	28,855.64	4,343.71	24,511.93
December 1, 1922	October 1922	30,681.87	4,543.29	26,138.58
January 2, 1923	November 1922	27,588.65	4,721.75	22,866.90
February 1, 1923	December 1922	27,135.65	4,003.89	23,131.76
March 1, 1923	January 1923	23,111.56	4,158.58	18,952.98
April 2, 1923	February 1923	19,309.31	3,660.45	15,648.86
May 2, 1923	March 1923	27,360.50	4,224.64	23,135.86
June 1, 1923	April 1923	30,663.24	4,484.54	26,178.70
July 2, 1923	May 1923	24,745.81	5,815.53	18,930.28
August 2, 1923	June 1923	21,297.78	4,477.25	16,820.53
September 1, 1923	July 1923	22,377.41	4,201.77	18,175.64
October 1, 1923	August 1923	30,219.86	5,669.41	24,550.45
November 1, 1923	September 1923	33,921.42	4,202.76	29,718.66
December 3, 1923	October 1923	37,907.72	5,885.60	32,022.12
January 2, 1924	November 1923	32,646.71	4,714.32	27,932.39
February 1, 1924	December 1923	25,405.06	4,614.80	20,790.26
March 1, 1924	January 1924	28,394.76	3,575.29	25,819.47
April 1, 1924	February 1924	24,512.81	3,803.40	20,709.41
May 1, 1924	March 1924	28,399.85	4,887.14	23,512.71
June 3, 1924	April 1924	29,246.94	4,530.91	24,716.03
July 1, 1924	May 1924	20,858.35	3,887.75	18,920.60
August 1, 1924	June 1924	18,777.06	2,699.53	15,077.53
September 3, 1924	July 1924	11,938.24	1,084.35	10,853.89
October 1, 1924	August 1924	13,044.63	1,197.15	11,847.48
November 1, 1924	September 1924	16,898.57	2,075.12	14,823.45
December 2, 1924	October 1924	18,212.35	2,245.46	15,966.89
January 2, 1925	November 1924	16,319.13	1,291.48	15,027.65
February 2, 1925	December 1924	19,704.88	2,120.48	17,584.40
March 2, 1925	January 1925	15,464.49	2,201.43	13,263.06
April 1, 1925	February 1925	11,751.17	2,058.92	9,692.25
May 2, 1925	March 1925	13,435.65	2,154.29	11,281.36
June 3, 1925	April 1925	10,999.77	1,237.40	9,762.37
July 1, 1925	May 1925	11,818.74	1,748.79	10,069.95
August 3, 1925	June 1925	11,528.05	2,274.24	9,253.81
September 2, 1925	July 1925	15,618.83	2,666.97	12,951.86
October 1, 1925	August 1925	12,367.67	1,859.34	13,508.33
November 4, 1925	September 1925	19,885.01	2,226.03	17,658.98
December 1, 1925	October 1925	25,838.60	3,683.11	22,155.49
January 2, 1926	November 1925	21,264.97	3,130.52	18,134.45
February 2, 1926	December 1925	18,877.46	1,904.65	16,972.81
March 2, 1926	January 1926	14,892.72	1,710.48	13,182.24
April 3, 1926	February 1926	9,277.10	1,685.64	7,591.46
Total		973,532.57	148,381.05	825,151.52

28

Exhibit "C" to complaint

TREASURY DEPARTMENT,
Washington, July 25, 1941.

OFFICE OF COMMISSIONER OF INTERNAL REVENUE

Address Reply to Commissioner of Internal Revenue and Refer to
IT:C1:CC:4-CCP

In re: Claim for refund of $229,805.34 For the year 1935

ELECTRIC STORAGE BATTERY CO.,
19th Street and Allegheny Avenue,
Philadelphia, Pennsylvania.

SIRS: Reference is made to the revenue agent's report upon an investigation of your tax liability dated Apr. 19, 1941, a copy of which was forwarded you, wherein you were informed that the claim for refund indicated above will be disallowed.

In accordance with the provisions of existing internal revenue law, notice is hereby given of the disallowance of your claim in full.

Respectfully,

GUY T. HELVERING, *Commissioner,*
By F. MOONEY, *Deputy Commissioner.*

In United States District Court

43

Answer

Filed December 15, 1943

Comes now the defendant, Walter J. Rothensies, Collector of Internal Revenue for the First District of Pennsylvania, by his attorneys, Gerald A. Gleeson, United States Attorney in and for the Eastern District of Pennsylvania, and Thomas J. Curtin, Assistant United States Attorney in and for said District, and answers the Complaint herein as follows:

FIRST COUNT AND CAUSE OF ACTION

1. Admits the allegations contained in Paragraphs 1, 4, 5, 8, 9, 10, 12, and 13 contained in the first count and cause of action of the Complaint.

2. Answering the allegations made in Paragraphs 2 and 3 of the first count and cause of action of the Complaint, the defend-

ant admits that he is the collector of Internal Revenue for the First District of Pennsylvania, which is situated in the Eastern District of Pennsylvania and that plaintiff made payment to him of the sum of $229,805.34 involved herein, but the defendant avers upon information and belief that the amounts of the excise
44 taxes described in Paragraphs 6 and 7 of the first count and cause of action of the complaint were paid to former Collectors of Internal Revenue for the same collection district, to wit: Ephraim Lederer, who was Collector from December 1, 1913, to July 31, 1921, and Blakely D. McCaughn, who was Collector from August 1, 1921, to December 31, 1927.

Further answering the allegations made in Paragraph 3 of the first count and cause of action of the complaint, the defendant admits that this is a proceeding of a civil nature for the recovery of Internal Revenue taxes and interest in the amount of $229,803.34, but he denies that said taxes and interest were erroneously and illegally assessed and collected.

3. Answering the allegations made in Paragraph 6 of the first count and cause of action of the complaint, the defendant admits that plaintiff made sales of portable electric storage batteries in each calendar year during the period which began on February 25, 1919, and ended on February 28, 1926, but the defendant denies that the excise taxes described therein were paid to him, and defendant further avers that he is without sufficient knowledge and information to form a belief as to the truth and accuracy of the other allegations contained in Paragraph 6 of the first count and cause of action of the complaint, and therefore, denies each and every allegation therein made except the allegation which is specifically admitted herein.

4. Answering the allegations made in Paragraph 7 of the first count and cause of action of the complaint, the defendant admits that plaintiff took as a deduction in computing its taxable net income reported in its federal income tax returns for
45 each of the calendar years 1919 to 1926, inclusive, the amounts of excise taxes described in Paragraph 6 of the first count and cause of action of the complaint, but the defendant denies the other allegations made in Paragraph 7 of the first count and cause of action of the complaint.

5. Answering the allegations contained in paragraph 11 of the first count and cause of action of the complaint, the defendant avers that the income taxes and excess profits taxes, with interest, in the total amount of $229,805.34, were paid on December 3, 1938, instead of on December 5, 1938, as alleged therein.

6. Denies the allegations contained in Paragraphs 14, 15, 16, 17, 18 and 19 of the first count and cause of action of the complaint.

SECOND COUNT AND CAUSE OF ACTION

7. Answering the allegations contained in the unnumbered paragraph immediately preceding the paragraph numbered 20 of the complaint, wherein plaintiff, for a second count and cause of action, repeats by references the allegations of paragraphs numbered 1 to 19, inclusive, of the complaint, the defendant realleges and repeats each and every admission and denial hereinbefore made with respect to paragraphs numbered 1 to 19, inclusive, of the complaint as though the same were here repeated in full.

8. Answering the allegations contained in Paragraph 20 of the second count and cause of action of the complaint, the defendant avers he is without sufficient knowledge and information to form a belief as to the truth and accuracy thereof,
46 and, therefore, denies each and every allegation therein made, except that the defendant admits that the excise taxes in the amount of $912,978.57 paid by plaintiff on sales of portable electric storage batteries for the period from April 1, 1919, to May 31, 1922, are not legally refundable to it by reason of the fact that the statute of limitations has intervened as a bar against the filing of a claim for refund thereof.

9. (a) Denies the allegations contained in Paragraph 21 of the second count and cause of action of the complaint.

(b) For a complete defense to the allegations contained in Paragraph 21 of the second count and cause of action of the complaint, the defendant avers that such allegations fail to state a claim against him upon which relief can be granted.

(c) For a further defense to the allegations made in Paragraph 21 of the second count and cause of action of the complaint, the defendant avers that by reason of the provisions of Section 3226 of the United States Revised Statutes, as amended, and/or Section 3772 of the Internal Revenue Code, the court lacks jurisdiction of the subject matter of the alleged overpayment of excise taxes for the period from February 25, 1919, to June 30, 1922, because no claim for the refund thereof setting forth the grounds upon which the plaintiff seeks to recover said taxes was presented to the Commissioner of Internal Revenue, as required by Section 3228, United States Revised Statutes, as amended by Section 1316 of the Revenue Act of 1921, c. 136, 42 Stat. 227.

10. Denies the allegations contained in Paragraph 22 of the complaint which plaintiff states apply to both the first
47 and second counts and causes of action of the complaint.

11. Admits the allegations contained in Paragraph 23 of the complaint which the plaintiff states apply to both the first and second counts and causes of action of the complaint.

Wherefore, defendant prays that the complaint be dismissed and that the defendant be given judgment in his favor against the plaintiff, together with the costs and disbursements herein expended by the defendant.

(S) GERALD A. GLEESON,
United States Attorney.
(S) THOMAS J. CURTIN,
Assistant United States Attorney.

48 In United States District Court

(Title omitted.)

Stipulation as to amendment to answer

Filed Nov. 29, 1944

And now, to wit: this — day of June, A. D., 1944, it is Stipulated and Agreed that the defendant be and hereby is permitted to file an amendment to the answer, heretofore filed.

(S.) CHARLES C. NORRIS, JR.,
Attorney for Plaintiff.
(S.) Gerald A. Gleeson,
GERALD A. GLEESON,
United States Attorney.
(S.) Thomas J. Curtin,
THOMAS J. CURTIN,
Assistant United States Attorney.

49 In United States District Court

(Title omitted.)

Amendment to answer

Filed Nov. 29, 1944

1. Defendant withdraws its admission that the books of the plaintiff were kept on the accrual basis for the entire period involved, but avers on the other hand that the books were kept on the cash receipts and disbursements basis during said period.

As a further affirmative defense, defendant avers:

1. The plaintiff received a deduction from its income for the years 1919 to 1922 inclusive in ascertaining its income tax liability in the amount of $912,978.57, upon which the defendant in equity should have received additional income taxes in the sum of $178,

691.49, and which additional taxes plus interest the defendant should be allowed to set off and recoup against any recovery by the plaintiff.

2. The plaintiff received a deduction from its income for the years 1922 to 1926 inclusive in ascertaining its income tax liability in the amount of $825,151.52, upon which the defendant, in equity, should have received additional income taxes in the
50 sum of $139,668.83, and which additional taxes plus interest the defendant should be allowed to set off and recoup against any recovery by the plaintiff.

(S.) GERALD A. GLEESON,
United States Attorney.
(S.) THOMAS J. CURTIN,
Assistant United States Attorney.

51 In United States District Court

[Title omitted.]

Agreed statement of facts

Filed Nov. 29, 1944

It is hereby stipulated by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the rights of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true, provided that either party hereto may object to the admission of any fact herein stipulated upon the ground of its incompetency, immateriality and irrelevancy.

1. The Electric Storage Battery Company, during the times hereinafter mentioned, was and now is a corporation organized and existing under the laws of the State of New Jersey, and
52 during all of the years hereinafter mentioned, its principal office was in the City of Philadelphia, County of Philadelphia, Commonwealth of Pennsylvania.

2. The defendant was at the time of the collection of the sum of $229,805.34 herein mentioned, and for the recovery of which this suit is brought, and still is, United States Collector of Internal Revenue for the First District of Pennsylvania, and a citizen and resident of the Eastern District of Pennsylvania.

3. During the period beginning February 25, 1919, and ending on February 28, 1926, the plaintiff was engaged in the business of manufacturing and selling electric storage batteries.

4. Each of the plaintiff's income tax returns and excess profits tax returns for the years 1919 to 1935, inclusive, have been audited and examined by the representatives of the Bureau of Internal Revenue.

5. In each month during the period beginning June 1, 1922, and ending February 28, 1926, the plaintiff made sales of electric storage batteries and made monthly returns of excise tax thereon and paid taxes thereon amounting to $825,151.52, in accordance with the provisions of Section 900 of the Revenue Act of 1921 and Section 600 of the Revenue Act of 1924. All of such sales were made to persons other than manufacturers of automobile trucks, automobile wagons, automobiles or motorcycles.

53 6. The payments of the excise taxes in question between July 31, 1922, and April 3, 1926, were made to the then Collector of Internal Revenue for said First District of Pennsylvania, who was the predecessor of the defendant herein.

7. The said excise taxes amounting to the sum of $825,151.52 were paid between July 31, 1922, and April 3, 1926, by the plaintiff upon demand of the then Collector of Internal Revenue. Under date of April 28, 1919, the plaintiff herein addressed a letter to the then Collector of Internal Revenue at Philadelphia, Pennsylvania, in which it protested the payment of excise tax for the period from February 25 to March 31, 1919, both inclusive. A true copy of said letter of April 28, 1919, is attached hereto and made a part hereof, as Exhibit "3." In the oral testimony of Mr. Augustus Stoughton in the case of the plaintiff vs. McCaughn, in the United States District Court for the Eastern District of Pennsylvania, June Term, 1928, he testified that he proceeded to Washington, D. C., and conferred with the then Commissioner of Internal Revenue concerning the payment of excise taxes assessed against the plaintiff herein, described in the letter of April 28, 1919, and protested to the Commissioner against the assessment and collection thereof; and upon return to Philadelphia, advised

54 the taxpayer to pay the tax and to say that it was paid under intention to avoid penalties, and to make a return therefor, and that was done. Further than that, the record of the evidence and documentary proof in the excise tax hearing fails to disclose any further protest made from time to time with respect to the assessments and payments of excise taxes by this plaintiff for subsequent periods up to and including the excise taxes assessed and paid up to April 3, 1926. Nevertheless, in the District Court's findings of fact, it made this specific finding:

"1. That payment of the excise taxes in suit was made under duress and after protest by the plaintiff against its collection."

8. The plaintiff made and filed its corporate income tax returns for the calendar years 1922 to 1926, inclusive, showing a tax due thereon, which was duly assessed on such returns by the Commissioner of Internal Revenue, and on said returns of income so filed, plaintiff claimed, took, and the Commissioner of Internal Revenue allowed, deductions covering the amounts of manufacturer's excise taxes paid during the period from 1922 to 1926, inclusive, which reduced the amounts of income tax due from plaintiff for such period, and resulted in a benefit to plaintiff for each of such years as follows:

Period	Excise tax paid	Rate	Income tax deduction	Interest June 5, 1944	Total
1922	$286,769.89	12½	$35,846.24	$45,644.21	$81,490.45
1923	330,696.97	12½	41,337.12	50,155.71	91,492.83
1924	253,007.75	12½	31,625.97	36,475.29	68,101.26
1925	192,677.83	13	25,048.12	27,385.94	52,434.06
1926	43,047.28	13½	5,811.38	6,005.09	11,816.47
Total			139,668.83	165,666.24	305,335.07

55 9. On July 19, 1926, the plaintiff filed with the Collector of Internal Revenue for the First District of Pennsylvania a claim for refund of the said manufacturers' excise taxes collected from the plaintiff from July 31, 1922, to April 3, 1926, in the amount of $825,151.52, a copy of which claim for refund is attached to the Complaint filed in this case, marked Exhibit "D", and by reference made a part hereof, which said claim for refund was rejected by the Commissioner of Internal Revenue on January 7, 1927.

10. A suit for the collection of the excise taxes exacted from the plaintiff during the period from July 31, 1922, to April 3, 1926, for batteries sold from June, 1922, to February, 1926, was filed against the then Collector of Internal Revenue on June 28, 1928, being No. 14,008 of June Term, 1928, at law, in the United States District Court for the Eastern District of Pennsylvania. After proceedings, on October 13, 1931, the District Court made the following entry:

"Before KIRKPATRICK, J.

"And now, to wit, October 13, 1931, judgment is entered in favor of the plaintiff, The Electric Storage Battery Company and against the defendant, Blakely D. McCaughn, formerly Collector of Internal Revenue of the United States for the First District of Pennsylvania, in accordance with the Findings of Fact and Conclusions of Law by Kirkpatrick, J. filed on April 28, 1931 for the following:

56 "1. *Amount of taxes paid on the following respective dates with interest thereon from the respective dates of payment, to wit:*

"Date of payment of tax	Amount of tax paid	Interest from date of payment to November 12, 1930
July 29, 1922	$20,750.15	$10,319.08
Aug. 31, 1922	20,964.09	10,313.76
Sept. 30, 1922	25,252.34	12,302.07
Oct. 30, 1922	28,855.64	13,912.37
Nov. 29, 1922	30,681.87	14,639.46
Dec. 30, 1922	27,588.65	13,025.62
Jan. 31, 1923	27,138.68	12,671.60
Feb. 28, 1923	23,111.96	10,676.91
Mar. 31, 1923	19,309.31	8,823.83
Apr. 30, 1923	27,260.50	12,366.20
May 31, 1923	30,663.24	13,705.63
June 30, 1923	24,745.81	10,936.97
July 31, 1923	21,297.78	9,306.55
Aug. 31, 1923	22,377.41	9,656.43
Sep. 30, 1923	30,219.85	12,903.05
Oct. 31, 1923	33,921.42	14,313.91
Dec. 1, 1923	37,907.72	15,800.25
Dec. 31, 1923	32,646.71	13,449.55
Jan. 31, 1924	25,405.06	10,339.16
Feb. 29, 1924	29,394.76	11,815.89
Mar. 31, 1924	24,512.81	9,730.91
Apr. 30, 1924	28,399.85	11,131.96
June 2, 1924	29,246.94	11,308.15
June 30, 1924	20,858.35	7,907.32
July 31, 1924	18,777.06	7,078.4[illegible]
Sep. 2, 1924	11,938.24	4,436.77
Sep. 30, 1924	13,044.63	4,787.02
Oct. 31, 1924	16,898.57	6,116.82
Dec. 1, 1924	18,212.35	6,498.32
Dec. 31, 1924	16,319.13	5,743.89
Jan. 31, 1925	19,704.88	6,837.05
Feb. 28, 1925	15,464.49	5,286.43
Mar. 31, 1925	11,781.17	3,959.82
May 1, 1925	13,435.65	4,455.06
June 2, 1925	10,969.77	3,593.01
June 30, 1925	11,818.74	3,805.31
Aug. 1, 1925	11,528.05	3,662.18
Sept. 1, 1925	15,518.83	4,870.08
Sept. 30, 1925	15,367.67	4,717.45
Nov. 2, 1925	19,885.01	5,998.19
Nov. 30, 1925	25,838.09	7,673.36
Dec. 31, 1925	21,264.97	6,208.79
Feb. 1, 1926	18,877.46	5,414.21
Mar. 1, 1926	14,892.72	4,196.89
Apr. 1, 1926	9,277.10	2,567.98
Total	973,532.57	389,328.70
Grand total		1,362,861.27

57 "2. and interest on $973,532.57, being the total amount of taxes paid, from November 12, 1930 to April 28, 1931 ..... $26,934.40

"3. and interest on $973,532.57, being the total amount of taxes paid, from April 28, 1931 to October 13, 1931 ..... 26,772.14

Total amount of taxes paid and interest from the respective dates of payment to October 13, 1931 ..... 1,416,567.81

"4. and interest upon the total amount of taxes paid, $973,532.57, from October 13, 1931, according to law.

By the Court.

Attest:

(Sgd.) GEORGE BRODBECK,
Clerk."

Upon appeal by the defendant, the Circuit Court of Appeals entered a mandate affirming the aforesaid action of the District Court.

11. On May 11, 1933, the plaintiff filed with the then Commissioner of Internal Revenue a judgment claim on Treasury Department Form 843, in which it demanded to be refunded $1,416,567.81, together with interest thereon from October 13, 1931, the principal sum being the amount described in paragraph 10 of this stipulation. The Commissioner of Internal Revenue refused to allow said judgment claim for the alleged reason that, in his opinion, the provisions of Section 424 of the Revenue Act of 1928 had not been complied with by the plaintiff in its proceedings before the United States District Court, in that plaintiff had failed to offer evidence and to prove what amount, if any, of the taxes collected from the plaintiff had been passed on to its customers, and that in
58 view of the decision of the United States Supreme Court in case of *Williard Storage Battery Company* vs. *Routzahn*, 291 U. S. 645, 78 L. Ed. 859 (1934), the District Court's alleged judgment of $1,416,567.81 and the Circuit Court of Appeal's mandate affirming the District Court were both void. Pursuant to an offer of settlement under date of October 16, 1934, to the Commissioner of Internal Revenue to exclude the principal sum of $148,381.05, representing the amount of excise taxes passed on to plaintiff's vendees, the Commissioner of Internal Revenue, after having satisfied himself after an investigation by an Internal Revenue Agent that the sum of $148,381.05 represented the amount of excise taxes which plaintiff had passed on to its customers, with the approval of the Attorney General of the United States, accepted said offer of settlement, and authorized the disbursing clerk of the Treasury Department on September 25, 1935, to refund to the plaintiff the sum of $1,395,515.35, of which amount $570,363.83 represented interest, the balance representing excise taxes in the amount of $825,151.52 which had not been passed on. A certified copy of the Commissioner's Schedule of Refunds, Treasury Department Form 7809, dated September 25, 1935, authorizing this refund, is attached hereto, made part hereof, and marked Exhibit 4. Thereafter, under date of October 15, 1935, the Treasury Department issued its check to the plaintiff for the sum of $1,395,515.35, representing a refund of the aforesaid excise taxes and interest thereon.

12. Of the said sum of $1,395,515.35 paid by the
59 United States to the plaintiff, only the sum of $36,351.88 was included by the plaintiff in its return of income and excess profits taxes for the year 1935, as representing what plaintiff regarded as interest accrued from January 1, 1935, to October 15, 1935.

13. On or about November 22, 1938, the plaintiff received notice and demand from the defendant for payment of additional income and excess profits taxes for the yea 1935, upon the ground that there should have been included in the plaintiff's return of income for that year, in addition to the amount of $36,351.88, the amount of the said refund of excise taxes in the principal sum of $825,151.52, and the remaining interest thereon amounting to $534,011.95, as recommended by a Revenue Agent's report dated January 7, 1937.

14. The notice and demand for the payment of additional income and excess profits taxes was based upon the following computation of such additional taxes for the year 1935, which included in the plaintiff's income the said refunds of excise taxes and interest thereon:

Additional income tax claimed for the year 1935	$188,140.56
Interest on above amount to November 18, 1938	30,195.27
Additional excess profits tax claimed for the year 1935	9,883.31
Interest on above to November 18, 1938	1,586.20
Total	229,805.34

60 15. On or about December 5, 1938, the plaintiff paid to the defendant the said income and excess profits taxes and interest in the total amount of $229,805.34 under protest, and with notice that refund thereof would be claimed.

16. On or about November 30, 1940, th plaintiff filed with the defendant, as Collector of Internal Reven e of the United States for the First District of Pennsylvania, a claim for refund in the amount of $229,805.34, a certified copy of which said claim for refund is attached hereunto, made part hereof, and marked Exhibit 5A.

17. The said claim for refund in the amount of $229,805.34 was disallowed in full by the Commissioner of Internal Revenue by registered letter dated July 25, 1941, a true copy of which letter is attached to the Complaint filed in this suit, a certified copy of which is attached hereunto, made part hereof, and marked Exhibit 5B.

18. In the taxable year of 1935, plaintiff reported as taxable income for that year, credited to surplus on its books, a refund of $769.78, representing Massachusetts excise taxes which previously had been charged to expenses in a prior taxable year and allowed as a deduction in such year.

19. Plaintiff incurred legal fees and expenses aggregating $48,622.46 in years prior to the taxable year 1935 in connection with the litigation for the refund of the aforesaid excise taxes.

61 The items making up the total of $48,622.46 were carried on plaintiff's books in a suspense account until the litigation was finally settled in 1935, and then the total amount was charged

to surplus on the taxpayer's books, as an offset against the sum of $1,395,515.35 received in that year as a refund of excise taxes paid for the period from June 1, 1922, to February 28, 1926, in the amount of $825,151.52, plus interest thereon in the amount of $570,363.83, of which total amount the sum of $1,359,163.47 was credited to surplus for the reason that plaintiff regarded these items as properly referable to the prior years 1922 to 1926, inclusive; and the difference of $36,351.88 was credited to profit and loss as interest applicable to the year 1935. The items making up the total $48,622.46 were taken as income deductions for 1935, which deductions the Commissioner of Internal Revenue allowed.

20. Plaintiff paid to its managers and other employees in the year 1935 bonuses aggregating $33,006.00, based on four per cent. (4%) of the principal amount of $825,151.52 received in that year as a refund of excise taxes, which sum of $33,006.00 was allowed to plaintiff as a deduction in computing its net taxable income for the year 1935. This bonus payment was based on a practice which was in existence during the period 1922 to 1926 inclusive, whereby the plaintiff paid its managers and certain other employees a bonus of four per cent. (4%) on the plaintiff's net operating profit realized from the sale of the plaintiff's products. The adjust-
62 ment made in 1935 represented the underpayment of bonus during the years 1922 to 1926 inclusive, because of the deduction from operating profits in those years of the amounts of excise taxes paid aggregating the said sum of $825,151.52.

21. Of the aforesaid $148,381.05 which represented excise taxes which were passed on to purchasers of the plaintiff's storage batteries and not refunded to plaintiff as aforesaid, there was included the sum of $11,703.50, which represented excise taxes upon the sales of storage batteries to Railway Express Company which were passed on to the said purchaser. In the year 1935 the plaintiff voluntarily paid to the said Railway Express Company the said sum of $11,703.50, which was allowed by the Commissioner of Internal Revenue as a deduction from the plaintiff's taxable income for the year 1935.

22. In each month during the period beginning March 1, 1919, and ending May 31, 1922, the plaintiff made sales of electric storage batteries, and made monthly returns of excise taxes thereon and paid taxes thereon amounting to $1,008,676.63, in accordance with the provisions of Section 900 of the Revenue Act of 1918 and Section 900 of the Revenue Act of 1921.

23. The payments of the excise taxes in question between April 28, 1919, and June 27, 1922, were made to the then Collectors
63 of Internal Revenue for said First District of Pennsylvania, who were predecessors of the defendant herein.

24. The said excise taxes amounting to the sum of $1,008,076.63 were paid between April 28, 1919, and June 27, 1922, by the plaintiff upon demand of the then Collector of Internal Revenue. Under date of April 28, 1919, the plaintiff herein addressed a letter to the then Collector of Internal Revenue at Philadelphia, Pennsylvania, in which it protested the payment of excise tax for the period from February 25 to March 31, 1919, both inclusive. A true copy of said letter of April 28, 1919, is attached hereto and made a part hereof, as Exhibit 3. In the oral testimony of Mr. Augustus Stoughton in the case of the plaintiff vs. McCaughn, in the United States District Court for the Eastern District of Pennsylvania, June Term, 1928, he testified that he proceeded to Washington, D. C., and conferred with the then Commissioner of Internal Revenue concerning the payment of excise taxes assessed against the plaintiff herein, described in the letter of April 28, 1919, and protested to the Commissioner against the assessment and collection thereof; and upon return to Philadelphia, advised the taxpayer to pay the tax and to say that it was paid under intention to avoid penalties, and to make a return therefor, and that was done. Further than that, the record of the evidence and documentary proof in the excise tax hearing fails to dis-
64 close any further protest made from time to time with respect to the assessments and payments of excise taxes by this plaintiff for subsequent periods up to and including the excise taxes assessed and paid up to April 3, 1926. Nevertheless, in the District Court's findings of fact, it made this specific finding:

"1. That payment of the excise taxes in suit was made under duress and after protest by the plaintiff against its collection."

25. Of the gross excise taxes amounting to $1,008,076.63 paid between April 28, 1919, and June 27, 1922, the sum of $95,098.06 represented excise taxes paid upon the sale of component parts of the said electric storage batteries, and was refunded by the United States to the plaintiff.

26. The net amount of the excise taxes in the sum of $912,978.57 paid between April 28, 1919, and June 27, 1922, was deducted from the income on the plaintiff's income tax returns for the years 1919 to 1922, inclusive.

27. The excise taxes paid by the plaintiff between April 28, 1919, and June 27, 1922, were in the amounts and at the times set forth in the statement thereof hereunto attached and marked Exhibit 6, upon which statement also is set forth the amounts of excise taxes which were refunded by the United States to the plaintiff.

65 28. No claim for refund of the said excise taxes paid between March 1, 1919, and May 31, 1922, was made by the

plaintiff and no suit was instituted for the recovery of said excise taxes, for the reason that on July 19, 1926, the filing of a claim for refund and a suit for the recovery of said excise taxes were then barred by the Statute of Limitations.

29. On or about November 3, 1938, the plaintiff executed and delivered to the Commissioner of Internal Revenue Waiver of Restrictions on Assessment and Collection of Deficiency in Tax, Form 870, as to the balance of deficiency of income and excess profits taxes for the year 1935, in the sum of $229,805.34; and in the said Waiver the plaintiff stated: "The execution of this Waiver is not an admission of liability for deficiency in tax and if the amount of the alleged deficiency is paid refund thereof will be claimed".

66 30. The reduction of plaintiff's income and excess profits taxes effected for the years 1919 to 1922, inclusive, as a result of the deductions of the said excise taxes paid during each of said years, respectively, amounts to the sum of $178,691.52, with interest thereon to June 5, 1944, amounting to $244,709.51.

31. The additional income and excess profits taxes amounting to the sum of $229,805.34 paid to the defendant on December 3, 1938, and for the recovery of which this suit is instituted, and all of the excise taxes paid by the plaintiff, upon the sale of electric storage batteries, between April 28, 1919, and April 3, 1926, to the Collectors of Internal Revenue for the First District of Pennsylvania then holding office at the time of such payments, respectively, were paid by the defendant and by the said Collectors of Internal Revenue, respectively, to the Treasurer of the United States, in accordance with the Statutes of the United States providing for and directing such payments.

Philadelphia, Pa., June 5, 1944.

(Sgd.) Charles C. Norris, Jr.,
CHARLES C. NORRIS, JR.,
Attorney for the Plaintiff,
1500 Walnut Street, Philadelphia, Pennsylvania.

(Sgd.) GERALD A. GLEESON,
United States Attorney.

(Sgd.) THOMAS J. CURTIN,
Assistant United States Attorney.

(Sgd.) LELAND T. ATHERTON,
Special Assistant to the Attorney General.

87 In United States District Court

Plaintiff's requests for findings of fact and conclusions of law

Filed Aug. 2, 1944

The Plaintiff, by its attorneys, Charles C. Norris, Jr., John Ross, and William P. Cairo, respectfully requests the Court to make the following findings of fact and conclusions of law, to wit:

FINDINGS OF FACT

1. The plaintiff, The Electric Storage Battery Company, was organized under the laws of the State of New Jersey and had its principal office in Philadelphia, County of Philadelphia, Commonwealth of Pennsylvania, and is and was engaged in the business of manufacturing and selling electric storage batteries. (Stip. pars. 1 and 3, R. 52 and 53.)

2. The defendant is the United States Collector of Internal Revenue for the First District of Pennsylvania, and a resident and a citizen of the Eastern District of Pennsylvania, and was acting in such capacity during 1935 at the time of the collection of the sum of $229,805.34 herein mentioned. (Stip. par. 2, R. 52.)

88 3. In each month during the period beginning June 1, 1922, and ending February 28, 1926, the plaintiff made sales of electric storage batteries, and made monthly returns early in the following month of manufacturers' excise taxes thereon and paid as taxes on sales thereof during such period $825,151.52 as required by the then Collector of Internal Revenue for the First District of Pennsylvania as the Collector and the Commissioner required under the provisions of Section 900 of the Revenue Act of 1921 and Section 600 of the Revenue Act of 1924. All of such sales were made to persons other than manufacturers of automobile trucks, automobile wagons, automobiles or motorcycles. (Stip. par. 5, R. 53 and 54.)

4. The plaintiff kept its books and records on the accrual calendar basis from 1919 to 1935, inclusive (P. Exs. 14 & 15 and R. 29 & 30); and prepared and filed its income tax returns during that period on the same basis. (P. Exs. 14 & 15, R. 235 and 238.)

5. Each of the plaintiff's income tax and excess profits tax returns for the years 1919 to 1935, inclusive, was examined and audited by the representatives of the Bureau of Internal Revenue. (Stip. par. 5, R. 53.)

6. The payment of excise taxes in the sum of $825,151.52 between July 31, 1922, and April 3, 1926, was made by plaintiff, under protest to avoid penalties, upon demand of the then Collector of Inter-

nal Revenue (Stip. pars. 6 and 7, R. 53), and such sums were in turn paid by the then Collector of Internal Revenue for the First District of Pennsylvania to the Treasurer of the United States pursuant to R. S. 3210, amended as Sec. 1031 (b) Revenue Act of 1924—43 Stat. 351—26 U. S. C. A. Int. Rev. Acts p. 139.

89 (Stip. par. 31, R. 71 and 72.) 7. In the plaintiff's corporate income tax returns for the years 1922 to 1926, inclusive, the plaintiff, after making payment of such excise taxes under protest to avoid penalties, claimed, and the Commissioner of Internal Revenue allowed, as deductions such excise taxes paid, which deductions resulted in a reduction of the amount of income tax due from the plaintiff for such period, exclusive of interest, of the sum of $139,668.83. This sum, when added to interest computed at at the rate of 6% to June 5, 1944, made a total of $305,335.07 and resulted in a benefit of that sum to the plaintiff. (Stip. Par. 8, R. 56.) Likewise, the plaintiff benefited by the deduction from its taxed income in 1919, 1920, 1921, and 1922 of $534,205.04 excise taxes paid during the 1919–1922 period, with interest computed to June 5, 1944, to the extent of $423,401.03. (Stip. par. 31, R. 71.)

8. On July 19, 1926, the plaintiff filed with the Collector of Internal Revenue for the first District of Pennsylvania a claim for refund of said manufacturers' excise taxes collected from the plaintiff during the period from July 31, 1922, to April 3, 1926, in the amount of $825,151.52, and such claim for refund was rejected by the Commissioner of Internal Revenue on January 7, 1927. (Stip. par. 9, R. 57 and Ex. D to Comp.)

9. A suit for the collection of the excise taxes exacted from plaintiff during the period from July 31, 1922, to April 3, 1926, was filed against the then Collector of Internal Revenue on June 28, 1928, being No. 14,908 on the June 1928 calendar at law in United States Court for the Eastern District of Pennsylvania. After trial and due proceedings on October 13, 1931, this court entered judgment in favor of the taxpayer therein (the plaintiff herein) for the sum of $1,416,567.81, and the mandate of the Circuit Court of Ap-

90 peals for the Third Circuit was entered affirming the decision of this court. (Stip. par. 10, R. 57.)

10. After negotiations between the representatives of the plaintiff and the Government the plaintiff agreed to accept and the Government to pay $1,395,515.35, representing the refund of illegally exacted excise taxes which had been absorbed by plaintiff, with interest thereon, and a check for this sum was issued to plaintiff on October 15, 1935. (Stip. par. 11, R. 62.)

11. Of the total sum of $1,395,515.35 paid by the United States to the plaintiff on October 15, 1935, $825,151.52 of this sum represented principal and the remainder thereof in the sum of $570,363.83 represented interest. Of the latter sum, $36,351.88

represented the amount of interest paid and accruable from January 1 to Octobre 15, 1935, and was included as a part of plaintiff's gross income for that year. (Stip. pars. 12 and 13, R. 63.)

12. On examination of the plaintiff's books and records the agents of the Commissioner of Internal Revenue included all of the refund of principal and interest received by plaintiff on October 15, 1935, except the sum of $36,351.88 reported by plaintiff as a part of this gross income during that year and as a result thereof notice and demand for the payment of additional income and excess profits taxes for 1935, with interest thereon, in the total sum of $229,805.34 was demanded from plaintiff. (Stip. pars. 13 and 14, R. 63 and 64.)

13. On or about December 5, 1938, the plaintiff paid to the defendant herein the said income and excess profits taxes, with interest thereon, in the total sum of $229,805.34 under protest with notice to the Commissioner of Internal Revenue and the Collector of Internal Revenue of the First District of Pennsylvania,
91 that refund thereof would be claimed. (Stip. par. 15, R. 64.)

14. On November 30, 1940, the plaintiff filed with the defendant herein as Collector of Internal Revenue of the United States for the First District of Pennsylvania a claim for refund in the amount of $229,805.34. (Stip. par. 16, R. 64, and Ex. 5A to Stip.)

15. The said claim for refund in the amount of $229,805.34 was disallowed in full by the Commissioner of Internal Revenue on July 25, 1941. (Stip. par. 17, R. 65, and Ex. 5B to Stip.)

16. In each month during the period beginning March 1, 1919, and ending May 31, 1922, the plaintiff made sales of electric storage batteries and made monthly returns of excise taxes thereon and paid such taxes amounting to $1,008,076.63, to the then Collectors of Internal Revenue for the First District of Pennsylvania upon demand of such Collectors under their interpretation of the provisions of Sections 900 of the Revenue Acts of 1918 and 1921. (Stip. pars. 22 and 23, R. 67 and 68.)

17. The payments of said excise taxes in the sum of $1,008,076.63 were made under duress and after protest by plaintiff against its collection. (Stip. par. 24, R. 68.)

18. Of the gross excise taxes in the sum of $1,008,076.63 paid between April 28, 1919, and June 27, 1922, the sum of $95,098.06 represented excise taxes paid upon the sale of component parts of electric storage batteries and was refunded by the United States to the plaintiff. (Stip. par. 25, R. 70.)

19. The net amount of excise taxes in the sum of $912,978.57 paid between April 28, 1919, and June 27, 1922, was deducted from
92 the income of the plaintiff's income tax returns for the years 1919 and 1922 inclusive. (Stip. par. 26, R. 70.)

20. Of the sum of $912,978.57 paid as excise taxes by the plaintiff between April 28, 1919, and June 27, 1922, the net sum of $534,205.04 was absorbed by the plaintiff (R. 38—P. Ex. 16, R. 239) and the remaining amount of such excise taxes paid by plaintiff was passed on to the purchasers of said batteries. (R. 38—P. Ex. 16, R. 239.)

21. The plaintiff did not increase the price of its electric storage batteries at the time of the advent of the imposition tax on February 25, 1919, nor was any increase thereon made until approximately one year after the imposition of such tax. (Sec. 900, Rev. Act 1918, R. 38 and 39.)

22. The subsequent increase in plaintiff's price of storage batteries was not due to the imposition of the excise tax in question under Section 900 of the Revenue Act of 1918, but was due to the increase in cost of lead, antimony, and other products used in the manufacture of electric storage batteries. (R. 38 & 39—P. Exs. 17 & 18, R. 240–242.)

23. The electric storage batteries manufactured and sold by the plaintiff upon which excise taxes were paid between April 28, 1919, and June 27, 1922, were the same type of batteries manufactured and sold by plaintiff upon which excise taxes were paid during the period from July 31, 1922, to April 3, 1926, and were not primarily adaptable only to automobiles but were equally adaptable to use in stationary engines and marine engines, and for other purposes where the duty requirement was the same and were used interchangeably for that purpose. (R. 20–27—P. Exs. 1–13, R. 103–105, 166–167, 182–183, 202–203, 221–231.)

93 24. The $229,805.34 additional income and excess profits taxes for 1935 paid by plaintiff to defendant, and the $912,978.57 net amount of excise taxes, which includes the net sum of $534,205.04 thereof absorbed by plaintiff, paid by plaintiff between April 28, 1919, and June 27, 1922, to the then Collectors of Internal Revenue, predecessors of defendant, were in turn paid by defendant and by the said Collectors, respectively, to the Treasurer of the United States, pursuant to R. S. 3210, amended as Sec. 1031 (b) of the Revenue Act of 1924, 43 Stat. 351, 26 U. S. C. A. Int. Rev. Acts p. 139. (Stip. par. 31, R. 71 and 72.)

94 CONCLUSIONS OF LAW

1. The refund of $825,151.52 of excise taxes illegally collected, paid to plaintiff on October 15, 1935, was not income subject to Federal Income Tax for 1935 or any other year.

2. The refund of $570,363.83 interest on illegally collected excise taxes, paid to plaintiff on October 15, 1935 was not income subject to Federal Income Tax for 1935 or any other year.

3. The refund of $825,151.52 of excise taxes illegally collected in the years 1922, 1923, 1924, 1925, and 1926, paid to plaintiff on October 15, 1935, is allocable to and among the years 1922, 1923, 1924, 1925, and 1926.

4. The refund of $534,011.95 of interest for the period from July 31, 1922 to December 31, 1935, inclusive, upon the refunded $825,151.52 excise taxes illegally collected, paid to plaintiff on October 15, 1935, was not income to plaintiff subject to income tax for the year 1935.

5. The payment by plaintiff of the $534,205.04 excise taxes during the period from April 28, 1919, to June 27, 1922 made under duress and protest, and the deficiency assessment against plaintiff of the additional 1935 income and excess profits taxes and interest in the sum of $229,805.34, were part of the same transaction and had their origin in the erroneous application of Sections 900 of the Revenue Acts of 1918 and 1921.

6. The plaintiff is entitled to recoup, against the claimed $305,641.10 additional 1935 Federal income and excess
95 profits taxes and interest thereon to June 5, 1944, the $1,275,-368.63 aggregate 1919–1922 excise taxes and interest thereon to June 5, 1944, less the $728,736.10 aggregate additional income and excess profits taxes for the years 1919–1926 and interest thereon to June 5, 1944 to which the Federal Government is equitably entitled.

7. The plaintiff is entitled to judgment against the defendant in the amount of $229,805.34, together with interest thereon at the rate of six per centum per annum from December 5, 1938, to the date hereof.

Respectfully submitted.

(S) CHARLES C. NORRIS, JR.,
(S) JOHN ROSS,
(S) WILLIAM P. CAIRO,
Attorneys for plaintiff.

96 In United States District Court

[Title omitted]

Defendant's requests for findings of fact and conclusions of law

Filed Aug. 9, 1944

The above-entitled cause on June 5, 1944, duly and regularly came on for trial herein before this Court sitting without a jury. Having considered the testimony of the witnesses, the stipulated facts, the documentary evidence, and briefs of counsel, the Court makes and publishes the following:

FINDINGS OF FACT

1. The facts as to the return, assessment, payment, and claim for refund of the income and excess profits tax for the calendar year 1935, are as set forth in defendant's answer, paragraphs 10, 11, 12, 13, and 23.

2. All the facts contained in that certain "Agreed Statement of Facts", made on June 5, 1944, and duly executed by counsel for the parties herein; and it is true that an exact copy of the claim for refund filed by plaintiff on the 30th day of November, 1940, is attached to said "Agreed Statement of Facts", and is marked Exhibit 5A.

3. It is true that an exact copy of the claim for refund filed
97 by plaintiff on the 19th day of July, 1926, is attached to said "Agreed Statement of Facts" and is marked Exhibit D.

4. It is true that an exact copy of the Schedule of Refunds, Treasury Department Form 7809, which was signed by the Commissioner of Internal Revenue on September 25, 1935, authorizing the refund of $1,395,515.35, of which amount $570,363.83 was interest, and the balance of $825,151.52 was excise taxes illegally collected from plaintiff for the period from June 1, 1922, to February 28, 1926, is attached to said "Agreed Statement of Facts", and is marked Exhibit 4.

5. The plaintiff obtained a tax benefit of $17,510.99, exclusive of interest, in the taxable year 1935 on account of having claimed certain deductions in computing its taxable income for that year which were allowed by the Commissioner of Internal Revenue. The interest on the principal amount of $17,510.99 computed to June 5, 1944, is $8,638.17; and the entire benefit including interest to June 5, 1944, is $26,149.16. The deductions which resulted in this tax benefit were the following:

(a) $48,622.46 representing the sum of the legal fees and expenses incurred in years prior to 1935 in connection with litigation for the refund of the excise taxes amounting to $825,151.52 which were refunded to it in 1935;

(b) $33,006 representing the amount of bonuses paid in 1935 to its managers and other employees based on 4% of the principal amount of $825,151.52 received in that year as a refund of excise taxes. This bonus payment was based on a practice which was in existence during the period 1922 to 1926, inclusive, whereby the plaintiff paid its managers and certain other employees a bonus of 4% on its net operating profit realized from the sale of its products. The adjustment made in 1935 represented the
98 underpayment of bonus during the years 1922 to 1926, inclusive, because of the deduction from operating profits in those years of the amounts of excise taxes paid aggregating the sum of $825,151.52;

(c) $11,703.50 paid in the year 1935 to the Railway Express Company constituting excise taxes upon the sales of storage batteries to that company by the plaintiff which were passed on to that customer. This sum was included in the amount of $148,381.05 which represented excise taxes that had been passed on to the purchasers of the plaintiff's storage batteries and not refunded to it.

6. The plaintiff reported as taxable income in its federal income and excess profits tax return for 1935 a refund of $769.78, which had been credited to surplus on its books, representing Massachusetts excise taxes which previously had been charged to expenses in a prior taxable year and allowed as a deduction in such year.

7. The plaintiff obtained a tax benefit of $178,691.49, exclusive of interest, as the result of having claimed as deductions in its federal income tax returns for the years 1919 to 1922, inclusive, excise taxes amounting in the aggregate to $912,978.57, which were collected from it during the period from February [illegible], 1919, to June 30, 1922. The interest on the principal amount of $178,691.49, computed to June 5, 1944, is $244,70[illegible], and the entire benefit including interest to June 5, 1944, is $423,[illegible].

8. The plaintiff obtained a tax benefit of $139,668.83, exclusive of interest, as the result of having claimed as deductions in its federal income tax returns for the years 1922 to 1926, inclusive, excise taxes amounting in the aggregate to $825,151.52, which were collected from it during the period from July 1, 1922, to April 3, 1926, and subsequently refunded to it in 1935. The interest on the principal amount of $139,668.83 computed to June 5, 1944, is $165,666.24, and the entire benefit including interest to June 5, 1944, is $305,335.07.

9. The plaintiff's books of account were not kept on the strict accrual basis of accounting but were kept in accordance with a hybrid method of accounting in which the manufacturer's excise taxes assessed for the period from February 25, 1919, to April 3, 1926, were deducted in the years paid instead of being deducted in the years when the liability therefor was incurred or had accrued; and its income tax returns were made on the cash receipts and disbursements basis.

10. Plaintiff's income and excess profits tax for the calendar year 1935 was not overpaid.

From the above facts the Court concludes as a matter of law:

CONCLUSIONS OF LAW

1. The Commissioner of Internal Revenue properly included in the plaintiff's taxable income for the year 1935 the sum of $1,359,163.47, representing federal manufacturer's excise taxes in the

amount of $825,151.52 illegally collected from it during the period from July 31, 1922, to February 3, 1926, inclusive, which was refunded to plaintiff in the year 1935, and interest thereon in the amount of $570,363.83, which was refunded to it in that year.

2. The plaintiff is not entitled to set off or recoup any amount paid by it as federal manufacturer's excise taxes on the sale of electric storage batteries during the period from Febru-
100 ary 25, 1919, to June 30, 1922, which were assessed against it during that period.

3. The plaintiff is not entitled to any recovery in this action; the motion of the defendant for a judgment is sustained and judgment should be in his favor, with costs to be entered by the Clerk in due course.

It is so ordered:

_____,

District Judge.

101 In the District Court of the United States for the Eastern District of Pennsylvania

Civil Action No. 3299

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

Opinion

Filed Oct. 30, 1944

SUR PLEADINGS AND PROOF

Before (s) KIRKPATRICK, J.

This is a suit to recover income and excess profits taxes and interest in the sum of $229,805.34, assessed for the year 1935 and paid by the plaintiff under protest. The case was tried to the court without a jury, most, if not all, of the material facts being covered by a stipulation.

The taxpayer (keeping its books and making its returns upon the accrual basis) took deductions in its income tax returns for the years 1922 to 1926, inclusive, amounting in the aggregate to $825,151.52, representing manufacturer's excise taxes which had been assessed against it during those years upon the erroneous theory that the storage batteries which it manufactured were parts of automobiles within the meaning of the Revenue Acts. The

excise taxes were paid under protest to avoid penalties, upon demand of the then Collectors of Internal Revenue. The
102 deductions were allowed by the Commissioner and resulted in saving the plaintiff a total of $139,668.83 of income tax for the years in question.

In July 1926 the plaintiff filed a claim for refund of the excise taxes, which was rejected, and the plaintiff then brought suit and finally, on May 1, 1933, after an appeal to the Circuit Court of Appeals and denial of certiorari, obtained a judgment for $1,416,567.81, being the amount of excise taxes, with interest. After lengthy negotiations, the government, on October 15, 1935, paid the plaintiff $1,395,515.35, which sum the plaintiff accepted in full satisfaction of the judgment.

The Commissioner added the bulk of this sum [1] to the income returned by the plaintiff for 1935, and as a result assessed additional income and excess profits taxes amounting, with interest, to $229,805.34. This the plaintiff is seeking to recover in this suit.

An additional fact is that for the years 1919 to 1922, inclusive, the plaintiff paid, under protest, a total of $534,205.04 [2] as excise taxes upon the sale of its storage batteries—an amount not included in the claim for refund filed by it in 1926, because then barred by the statute of limitations.

The plaintiff bases its case upon alternative theories,
103 first, that the payment to it in 1935 was not income at all, but the restoration of a part of its capital which had been taken when the government, illegally, compelled it to pay the excise taxes in the years 1922 to 1926. Second, that, if income, it was properly accruable not for 1935 but for the years 1922 to 1926, and, consequently, the statute of limitations prevents assessment in 1935 of an additional tax in respect of it. Finally, the plaintiff contends that even if the assessment of the income tax in suit is held proper if is entitled to judgment by way of recoupment for the admittedly illegal excise taxes paid by it under protest between 1919 and 1922.

First. "The law is pretty well settled that * * * refunds of taxes erroneously and illegally collected constitute taxable income * * *". Universal Inc. v. Commissioner, 109 F. 2d 616. See also Nash v. Commissioner, 88 F. 2d 477 and Bimberg v. Helvering, 126 F. 2d 412. So far as I know, the rule of these cases has not been expressly rejected by any court decision.

The plaintiff contends that the payment of the excise taxes resulted in an impairment of its capital and that the exaction was in the nature of a trespass. The Board of Tax Appeals in a group

[1] All of it except the sum of $36,351.88 representing interest which the taxpayer admitted was earned from January 1, 1935, to September 15, 1935, and which it included in its report of its gross income for 1935.

[2] This was the amount of such taxes not passed on to the plaintiff's customers but absorbed by it.

of recently decided cases conceded as much but held that the subsequent refund was income, for the reason that "by the prior deduction of the amount of loss from taxable income the taxpayer has already had, for income tax purposes, a recoupment of the capital out of taxable income. Any further recovery is accordingly in
the nature of a replacement of taxable income and, being in
104 excess of the reduced cost of the capital asset, is equivalent
to gain to the taxpayer." Estate of James N. Collins v. Commissioner, 46 B. T. A. 765, 769; John V. Dobson v. Commissioner, 46 B. T. A. 770. See also Houbigant Inc. v. Commissioner, 31 B. T. A. 954. These cases held in effect that the money, upon its return, has lost its character as capital. This Court, in Philadelphia National Bank v. Rothensies, 43 F. Supp. 923 (a recovery of a bad debt case) took a somewhat different view and held that, although the money taken by the government remained capital even upon its return, the taxpayer, by claiming and receiving a benefit in respect of the loss in the form of a deduction in its income tax, had voluntarily consented that it be taxed as income in the event of its return, regardless of its nature. It does not matter which theory be accepted; whether the recovery be taxable as income or, by waiver or implied consent as capital, the result is the same.

Second. The refund being taxable income, the question is as to the year in which it is properly accruable. Judge Hand in Bimberg v. Helvering, supra, called attention to the distinction recognized by a number of decisions between situations in which the statute had run against assessment in the year of the illegal overcharge and those in which it had not. He said, "It has been several times held that the Commissioner may cancel a deduction taken in one year for a tax which the taxpayer has accrued or paid, when the tax has been refunded in a later year because it was unlawfully imposed. Inland Products Co. v. Blair, 4 Cir., 31 F. 2d 867; Leach v. Commissioner, 1 Cir. 50 F. 2d 371; Bergan v.
Commissioner, 2 Cir., 80 F. 2d 89 * * * On the other
105 hand, in several cases when the time has passed to assess a
deficiency for the earlier year, courts have allowed the Commissioner to surcharge the income for the year of the refund. Houbigant, Inc. v. Commissioner, 2 Cir., 80 F. 2d 1012; Nash v. Commissioner, 7 Cir. 88 F. 2d 447; Union Trust Co. v. Commissioner, 7 Cir., 111 F. 2d 60." In Bohemian Breweries v. U. S., 27 F. Supp. 588, 592, the Court of Claims referred to, as established, "the rule that an amount deducted and allowed from income in a certain year must be included in income when collected or recovered in a subsequent year when the correction of the return and the tax liability in a prior year is barred by the statute of limitations." Bimberg v. Helvering, supra, was a case in which,

although the statute had not run, the Commissioner's determination that the refund was income for the year in which it was received was sustained, mainly because the taxpayer itself had accrued it for that year by returning part of it, but the opinion goes beyond the facts and expressly approves the rule of the Houbigant case to the effect that if the statute has run the refund may be assessed against the taxpayer in the year in which it was received.

106 Although, in this case, the plaintiff's accounting was at all times upon an accrual basis,[3] that does not mean that
107 the plaintiff may attribute an item of income to any year it pleases or that its determination of the year is final and conclusive. The question still remains whether the income is properly and legally accruable in the year to which the taxpayer has attributed it.

In each of the two recent cases of Dixie Pine Products Co. v. Commissioner, 320 U. S. 516, and Security Flour Mills Co. 1. Commissioner, 321 U. S. 281, the taxpayer was on an accrual basis. In the Dixie Pine case the taxpayer had been assessed for and had paid a manufacturer's gasoline tax to the state of Mississippi upon a product which it claimed was not gasoline and had brought suit in the state court to recover the payment. It accrued the liability on its books for the year in which it had paid the tax and claimed a corresponding deduction from its income tax for that year. The court said, "Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated." In the Security Flour Mills case the taxpayer had not actually paid but had deposited, pendente lite, a processing tax the legality of which it was contesting. Meanwhile it had passed the tax on to its customers thereby assuming an obligation to reimburse them if the tax should be declared invalid. The tax was declared invalid, the impounded money was returned to the taxpayer and thereafter, in subsequent
108 years, refunds were made to the customers. In spite of the

[3] In the stipulation, filed in the suit for recovery of the excise taxes, there is a paragraph to the effect that the plaintiff "filed its corporation income-tax returns for the calendar years 1922 to 1926, inclusive, upon a cash receipts and disbursements basis * * *". I cannot agree with the defendant that this estops the plaintiff to prove, in this case, that the fact was otherwise. Not only was this part of the stipulation immaterial to the decision of that case, but I find that it was a pure oversight and inadvertently made by counsel. The stipulation contained a number of other matters of vital importance to the case, including a lot of figures which required careful checking. The trial was in progress when the stipulation was submitted and, except for the figures, was gone over rather hurriedly and the paragraph in question was obviously overlooked. Admissions of counsel inadvertently made will not be permitted to defeat a party's rights. Nesbitt, Assignee, Appellant, v. Turner, 155 Pa. 429. The paragraph in question will not be treated as an estoppel nor as res adjudicata in the present case.

fact that the taxpayer accrued the amount deposited as a liability for the year in which it was deposited, the court held that it was not entitled to a deduction for that year but must include in its income the total amount received from its customers in that year and take whatever deductions it was entitled to during the years in which refunds to the customers were made. The court said, "Since it denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the government's claim as an accrued liability. As it admittedly received the money in question in 1935 and could not deduct from gross income an accrued liability to offset it, the receipt, it would seem, must constitute income for that year."

In the Security Flour Mills case the court further said, "The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount." The question in the present case therefore is, in what year had the plaintiff's right to receive a refund of the excise tax which it illegally paid, become "final and definite in amount"? Obviously, under the rule of the two cases just cited, not in the years 1922 to 1926, during which the tax was paid. It is also plain from those decisions that the fact that the exaction was subsequently determined to be illegal did not mean that there had been from the moment it was paid an immediate final and definite obligation to return it or a
109 correlative right to receive it—at least so far as allocating income or outgo in respect of it is concerned.

In its suit for the recovery of the excise taxes the plaintiff obtained judgment in 1933, but neither party in this case contends that the amount of the judgment is income for that year. Perhaps under ordinary circumstances it would be, but a special situation existed which, the defendant contends, and I think rightly, postponed the finality and definiteness of the taxpayer's right to receive and the government's obligation to pay the money until the year 1935 when all disputed questions were settled by agreement and payment was finally made.

In the suit to recover the excise taxes both this Court and the Circuit Court of Appeals had ruled that the plaintiff did not have to prove as a substantive element of its right to recover that it had not directly or indirectly passed on the tax to purchasers of its storage batteries, and the evidence did not show what part, if any, of the tax had been so collected from its customers. Subsequently in U. S. v. Jefferson Electric Co., 291 U. S. 386, the Supreme Court held that this view was wrong, disapproving of the decisions of this Court and the Circuit Court of Appeals in that respect by

specific reference to them. After this plaintiff's judgment was obtained the Commissioner contended that, under the rule of U. S. v. Jefferson Electric Co., supra, not only had it been rendered upon an erroneous theory but that the court was without jurisdiction, and declined to pay it. Negotiations followed in the course of which the plaintiff satisfied the Commissioner as to how much of the tax it had passed on to its customers, and agreed that that amount would be deducted from the judgment. This controversy was not settled until 1935, and then the judgment, so reduced, was paid.

I do not think it necessary to pass upon the defendant's present contention that the judgment was merely what it calls, a "purported" judgment—no judgment at all, not a final or binding adjudication. The fact remains that, after its rendition, the Commissioner still contested, in good faith, the plaintiff's right to recover the full amount of the judgment and the plaintiff, for purposes of settlement and to obtain its money, apparently conceded at least that the Commissioner's position had some substantial merit, for it reduced its claim accordingly. Under these circumstances I think that the Government's contention is correct that the judgment lacked that absolute quality which would justify its accrual in any year prior to the final settlement of all controverted questions relating to the claim and that was the year in which payment was made.

Third. I think that the plaintiff is entitled to recoup against the deficiency assessment involved in this suit, the amount of excise tax illegally collected from it between 1919 and 1922.

Equitable recoupment is a rule of the law which diminishes the right of a party invoking legal process to recover a debt, to the extent that he holds money or property of his debtor, to which he has no moral right. Ordinarily a defensive remedy going only to mitigation of damages, it will be applied in favor of a taxpayer who has brought suit to recover an alleged overpayment of tax exacted by summary procedure or the threat of it. Bull v. U. S., 295 U. S. 247.

In this case the government has money which it collected illegally from this taxpayer, against its protest, and which it has no right to retain. Only the statute of limitations stands in the way of the taxpayer's right to recover and the statute of limitations is not exactly a moral value. The rights and wrongs of the situation might be more complicated if the taxpayer's main contention was to be sustained, because then it would be retaining a tax benefit which only an erroneous guess as to the law by the Commissioner put into its pocket and of which only the statute of limitations prevented the collection; but as it is, apart from technical considerations, the equities are so plain as to admit of

no disagreement among just and reasonable men. Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been illegally compelled to pay, and I think that the decisions of the courts fully justify such a solution.

The defendant contends that the plaintiff can have no right to recoupment in this case for two reasons. The first is that recoupment lies only in respect of a claim arising from the same transaction as that which is the basis of the adverse claim. That the two transactions must bear some reasonably definite relation to each other is recognized in all the decisions. Here the question is whether the illegal assessments of excise taxes for the years 1919 to 1922 bear a sufficiently close relation to the subject matter of this suit, namely, the refund of illegal assessments and collections of taxes imposed under the same statute upon articles of the
112 same description in subsequent years, to allow the application of the doctrine. The case of Dixie Margarine Co. v. Commissioner, 115 F. 2d 445, is on all fours with the present case and rules that it does. The court, in that case, said "the claim for refund and the deficiency assessment had a common origin, namely, the erroneous application of the Oleomargarine Act to petitioner's product, and petitioner's claim is therefore available in recoupment." Here the erroneous application of the Revenue Act to the plaintiff's product (storage batteries) gave rise to overpayments of 1919 to 1922, the refunds for 1922 to 1926 and the deficiency assessment for 1935 when the illegal exactions were restored. Dixie Margarine Co. v. Commissioner, supra, is a ruling by the Circuit Court of Appeals for the Sixth Circuit and, while not absolutely binding upon this court, ought to be followed unless it appears to be clearly erroneous. Far from that, it appears to be directly in line with the trend shown by the decisions of the Supreme Court in Lewis v. Reynolds, 284 U. S. 281; Bull v. U. S., supra, and Stone v. White, 301 U. S. 532, each of which marked a broadening of the scope of the doctrine and a step away from technical limitations upon it.

The other ground upon which the defendant denies the applicability of the doctrine of recoupment is the holding of McEachern v. Rose, 302 U. S. 56, to the effect that the limitation sections of the Revenue Act of 1928 preclude it. In that case the applicable sections were 607 and 609 (a), in the present case, 609 (b), but the distinction is immaterial.

Since the plaintiff can exercise the right of recoupment if no statutory provisions preventing it are applicable (American
113 Light & Traction Co. v. Harrison, 142 F. 2d 639), and since McEachern v. Rose, supra, holds that the limitation pro-

visions of the Revenue Act of 1928, so far as applicable, do impose a bar, the only question is whether those provisions are retroactive, because, in the present case, the overpayments were made long before the Act of 1928. The precise point was decided by the District Court in West Virginia Pulp and Paper Co. v. McElligott, 40 F. Supp. 765, 771. The court said, "A consideration of this policy seems to indicate that Sections 607 and 609 (b) should not be construed to have the retroactive effect of taking away the equitable defense of recoupment as applied to claims for refund of taxes assessed and paid before the enactment of those sections, which defense would otherwise be available." The defendant says simply that the West Virginia Pulp and Paper case is wrongly decided, and that both its rule and the plaintiff's position in the present case are clearly erroneous in that both are based on the proposition that recoupment is a substantive right whereas the defendant apparently considers it merely a procedural device. However, I think that it is a substantive right and I believe I may invoke the authority of Mr. Justice Roberts who said in Bull v. U. S., supra, "This procedural requirement does not obliterate his substantial right to rely on his cross-demand for credit of the amount which if the United States had sued him for income tax he could have recouped against his liability on that score." At any rate I agree that the Revenue Act of 1928 should not be construed retroactively and does not take away the right of recoupment which the plaintiff in this case otherwise has. In his dissenting opinion in American Light & Traction Co. v.
114 Harrison, 142 F. 2d 639, 645, Judge Evans came to the conclusion that the Section 820 (f) of the Revenue Act of 1938, "No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932," had not enlarged or lessened any right which accrued before January 1, 1932 and it will be noted as to this point he was not dissenting to anything said in the majority opinion. As to this, I am also in accord.

The plaintiff concedes that, if it is accorded recoupment, the government is entitled to a corresponding right to recoup the amount of income taxes and interest saved by the plaintiff during the years 1922–1926 together with the benefit received by the plaintiff in the saving of income taxes and interest during the 1919–1922 period. However, after allowing this and striking a balance, the government will still have in its hands more than the amount of taxes and interest which the plaintiff is endeavoring to recover in this suit.

Judgment may be entered for the plaintiff in the amount claimed.

Findings and conclusions

I adopt, as special findings of fact, the facts in the stipulation or "Agreed Statement of Facts" filed by the parties.

I affirm all of the plaintiff's requests for findings of fact, all of which, except Nos. 4, 20, 21, 22 and 23, are based upon the stipulation.

I affirm all the defendant's requests for findings of fact except No. 9 which is denied as stated.

115 I affirm the plaintiff's requests for conclusions of law Nos. 5, 6, 7 and deny Nos. 1, 2, 3 and 4.

I affirm defendant's requests for conclusions of law No. 1 and deny Nos. 2 and 3.

Judgment accordingly.

116 In the District Court of the United States for the Eastern District of Pennsylvania

Civil Action No. 3299

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

v.

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

Judgment

Filed Oct. 30, 1944

Before KIRKPATRICK, J.

And now, to wit: October 30th, 1944, in accordance with the Opinion of the Court filed this day, it is ORDERED that Judgment be and is hereby entered in favor of Plaintiff, The Electric Storage Battery Company and against Defendant, Walter J. Rothensies, Individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, in the sum of Two Hundred Twenty-Nine Thousand Eight Hundred and Five and 34/100 ($229,805.34) Dollars, together with interest from December 5th, 1938, and costs.

By the Court.

Attest:

(S.) GILBERT W. LUDWIG,
Deputy Clerk.

117 In United States District Court

Certificate of probable cause

Filed Nov. 3, 1944

And now, to wit: this 1st day of November, A. D., 1944, the court, on motion of the United States Attorney for the Eastern District of Pennsylvania, representing the defendant in the above-entitled cause, hereby certifies that there was probable and reasonable cause for the act of said defendant, as Collector of Internal Revenue, in demanding and collecting from the above plaintiff, the internal-revenue tax, for the refund of which a judgment has been entered in favor of the said plaintiff.

S. KIRKPATRICK, J.

118 In United States District Court

Notice of appeal to the Circuit Court of Appeals for the Third Circuit (Under Rule 73 (b))

Filed Jan. 26, 1945

Notice is hereby given that Walter J. Rothensies, Individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, defendant above named, hereby appeals to the Circuit Court of Appeals for the Third Circuit from the final judgment entered in this action on October 30, 1944.

S. GERALD A. GLEESON,
United States Attorney.
S. THOMAS J. CURTIN,
Assistant United States Attorney.

124 In United States Circuit Court of Appeals, for the Third Circuit

OCTOBER TERM, 1945

No. 8836

THE ELECTRIC STORAGE BATTERY CO., PLAINTIFF-APPELLEE

v.

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS U. S. COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, DEFENDANT-APPELLANT

Order assigning judge

Filed Oct. 4, 1945

And now, to wit: this 4th day of October A. D. 1945, it is ordered that Hon. Albert Lee Stephens, U. S. Circuit Judge, for the Ninth Circuit, District of ——, be, and he is hereby assigned to sit in above case in order to make a full court.

ALBERT B. MARIS,
Circuit Judge.

125 In the United States Circuit Court of Appeals for the Third Circuit

[Title omitted]

Minute entry

Oct. 4, 1945.

And afterwards, to wit, the 4th day of October, 1945, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Albert Lee Stephens, Honorable Albert B. Maris and Honorable Herbert F. Goodrich, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 27th day of November, 1945 come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

126 In the United States Circuit Court of Appeals for the Third Circuit

OCTOBER TERM, 1945

No. 8836

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

v.

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE, FIRST DISTRICT OF PENNSYLVANIA, APPELLANT

APPEAL FROM THE JUDGMENT OF THES DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued October 4, 1945

Before ALBERT LEE STEPHENS, MARIS and GOODRICH,

Circuit Judges

Opinion of the Court

Filed November 27, 1945

By GOODRICH, Circuit Judge.

This is a suit by a taxpayer to recover from the Collector
127 a sum which it alleges was wrongfully collected. The plaintiff was successful in the District Court and the Collector appeals.

The fact basis for the lawsuit is this: From 1919 to 1926 the taxpayer paid a large sum in excise taxes on the sale of its storage batteries; the government's exaction was based on the theory that the batteries were automobile accessories. Taxpayer disputed the legality of the tax and took appropriate action to preserve its rights to claim refund. In 1935 the government repaid to the taxpayer something more than a million dollars in settlement of a judgment which taxpayer had obtained to recover back the tax money paid by it. The period from 1919–1922 was not covered by the judgment, as claim for refund for the payments made during these years was barred by the statute of limitations. The money paid to the taxpayer in 1935 was treated as income for 1935 by the Commissioner, and this treatment resulted in the assessment of additional income and excess profits taxes for that year against the taxpayer. The taxpayer paid what was demanded with appropriate reservation of its rights and then sued to recover its money.

The plaintiff urged below and repeats here that payment of the judgment by the United States was not income to it in 1935. The District Court ruled against this contention and so do we. It is sufficient on this point to refer to our own decision and authorities cited in Freihofer Baking Co. v. Commissioner, — F. (2d) — (C. C. A. 3, 1945); 45-2 USTC par. 9400.

The interesting question is the one made the basis of the decision in the taxpayer's favor by the District Court. It involves taxpayer's right to meet its extra imposed tax liability of 1935 by recouping the payments it made from 1919–1922 upon this incorrectly imposed excise tax on the sale of its batteries. Refund for these payments, it will be remembered, is barred by lapse of time. The taxpayer admits this, but says that when being pressed to pay income tax on refund for some of those payments, it can recoup for the taxes it was illegally compelled to pay, even though it coud not sue for them.

128 For the purpose of deciding the rights and liabilities of the parties to this controversy, we may treat the case as though the taxpayer was being sued by the government and had set up its claim for recoupment to cut down the amount of recovery against it. The taxpayer does not lose his rights by the fact that he pays first and disputes the correctness of the payment later, if he takes the proper steps to preserve his claim. The difference between a claim by the government for taxes and the ordinary claim by one private litigant against another was discussed by the Supreme Court in Bull v. United States, 295 U. S. 247 (1935). That decision is authority for our approach to the question here.

Bull v. United States is also authority for the proposition that the defense of recoupment is not barred by the statute of limitations "so long as the main action is timely" (p. 262). That is, if the United States had sued this taxpayer for an alleged unpaid tax for 1935, the taxpayer would not be barred from setting up in recoupment a claim otherwise proper as recoupment, because suit on that claim by the taxpayer would be barred by the statute of limitations.

Is the taxpayer's claim in this case a proper subject for recoupment as against the government's claim for unpaid income tax for 1935? The Court in Bull v. United States says recoupment is in the nature of a defense "arising out of some feature of the transaction upon which the plaintiff's action is grounded". The turning point of this case is whether the taxpayer's claim meets this test. "Transaction" is manifestly the key word. Is taxpayer's claim for recoupment part of the "transaction" on which the government's claim for additional income tax for 1935 is grounded?

The argument for the taxpayer can be simply put. The additional tax asked for by the government was not from taxpayer's

income from its general business, but from the payment to
129 the taxpayer of the incorrectly collected excise tax on the sale of its batteries. The recoupment asked for was a stale claim for three additional years of payments on the same tax. Both government demand and taxpayer's claim had their origin in the same source in one sense. They grew out of seven years of improperly assessed excise taxes on the sale of batteries. In another sense, obviously, the sale of each battery over the seven years was a separate matter, carrying its own burden of tax and not the same transaction as that of the sale of another battery several years away, or, for that matter, another battery to a different buyer the same day. We doubt whether even the government argument would insist that individual battery sales constituted each its own "transaction". How many sales together make up a "transaction"? We see no reason for lumping them by calendar years. The nature of the merchandise sold was the same; the imposition of the tax was the same. What the taxpayer wants us to do, and what it persuaded the District Court to do, is to regard the sales over several years of this merchandise and the tax thereon as a "transaction" sufficient for application of the recoupment doctrine.

Recoupment, unlike set-off and counterclaim, is a product of judicial, not legislative action.[4] There is little or no help to be had from dictionary or judicial definition or description of the word "transaction" when applied in other situations, to its meaning as used here. If one turns to a discussion of its meaning in statutory counterclaim, he finds a recognized authority stating as follows:

"The only test, which can be consonant with the function of the counterclaim is whether the particular counterclaim could, in the court's discretion, be expediently tried with the plaintiff's case."[5]

130 This consideration of expediency is said to be back of the "transaction" element in recoupment[6] and is repeated in Waterman's textbook on the subject,[7] and ought to be applied where possible to produce results which accord with one's sense of fairness. It is not to be construed like a penal law and to have each word used in describing its application held to a precise and technical meaning. We need not take it as the sole criterion, and for the purpose of deciding this case, do not need to settle with exactness what the limits are. The doctrine of recoupment is

[4] Short summaries describing it may be found in Restatement, Judgments, p. 217, and in a paper "The Pleading of Counterclaims," by Charles E. Clark and Leighton H. Surbeck (1927–1928), 37 Yale L. Jour. 309.

[5] Clark article, supra, p. 316.

[6] "The Doctrine of Recoupment in Federal Taxation," by David H. McConnell (1942), 28 Va. L. Rev. 577.

[7] Waterman on Set-off, Recoupment, and Counterclaim (1869), 552. "Although recoupment is only available where both demands spring from one transaction; yet [illegible]ing claims, in order to be adjusted in this way in one action, need not be of the same character."

based on concepts of fairness.[8] We see no reason, therefore, for hedging the "transaction" part of the requirement within close quarters, especially where, as here, there is a logical connection between main claim and recoupment claim. As to the fairness of the matter, we agree with the District Court where his opinion stated:

"Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been illegally compelled to pay, and I think that the decisions of the courts fully justify such a solution."

All this leads to a conclusion that the taxpayer should prevail, unless some rule preventing recovery stands in the way. The same result is indicated by such judicial authority as there is upon the point. Bull v. United States, supra, is the foundation case.[9]

In that case, however, the main claim and recoupment claim
131 were more closely connected than they are here. The District Court believed Dixie Margarine Co. v. Commissioner, 115 F. (2d) 445 (C. C. A. 6, 1940) to be directly in point. We agree. Appellant admits the decision is in point, but says it is wrong. It also says that it is deprived of any persuasive authority because it was an appeal from the Board of Tax Appeals and in a later decision (Commissioner v. Gooch Co., 320 U. S. 418 (1943)) the Supreme Court has held that the Board of Tax Appeals has no jurisdiction of recoupment. That the Supreme Court has so held there is no doubt. Equally clear, we think, is that whatever value the Dixie Margarine decision has for us in its discussion of recoupment is not lessened by the fact that if the case came up again, it would go off on the jurisdictional question. There is no doubt that in the instant case, the District Court was a tribunal with general equity powers, and if recoupment is called for, it can be allowed. Whatever may be the status of the Dixie Margarine decision it is, of course, not binding upon us, and we must take the responsibility of deciding the present litigation in accordance with the law as we see it. There is no disposition to evade that responsibility.

STATUTORY PROVISIONS

The government further contends that recoupment is not available to the taxpayer here because of the statutory bar of §§ 608 (a) and 609 (b) of the Revenue Act of 1928. It cites the following language from § 608

[8] See the language of the Court in Crossett Lumber Co. v. United States, 87 F. (2d) 930, 932 (C. C. A. 8, 1937).

[9] McConnell, The Doctrine of Recoupment in Federal Taxation (1942), 28 Va. L. Rev. 577, 586: "The leading case on the application of recoupment in tax cases is Bull v. United States." At page 607, the article states as a conclusion, "Thus four principles seems apparent: (1) That the broad recoupment doctrine of Bull v. United States is still applicable in tax cases. * * *"

"A refund of any portion of an internal-revenue tax * * * shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, * * *"

and from § 609

"A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608."

132 Then it cites McEachern v. Rose, 302 U. S. 56 (1937).

The conclusion urged is that since the time for filing claims for refund of the 1919–1922 taxes had expired, a refund of them would be erroneous, and by the same token, a credit of the overpayment represented by those taxes given to taxpayer for 1935 taxes would be void under § 609 (b). The conclusion urged seems a long journey from the language of the statute cited. Does the statutory language mean that a taxpayer cannot have credit by recoupment in a case where he was too late to prosecute a claim for refund?

The first trouble we have with that conclusion is Bull v. United States, already quoted from. There, as here, the claim of the taxpayer arose before the 1928 statute the litigation in which it was set up as recoupment came later. The result in the Bull case seems contrary to the argument being discussed here, and that decision met no adverse criticism in McEachern v. Rose and was cited with apparent approval in Commissioner v. Gooch Co., 320 U. S. 418 (1943).

Argument for the taxpayer points out that the sections under consideration have nothing to do with courts; they are part of the Administrative Provisions in both the 1928 Act and in the later codification, and that they talk the language of direction to administrative officers in terms like making a refund or giving a credit. There is some persuasive force in this argument, but it is not consistent with the view of the Supreme Court in McEachern v. Rose, supra. There it is said: (pp. 59; 60) "We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result. But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him." The Court treats these sections as making a rule for courts as well as commissioners and collectors. It is to be noted, however, that

133 the language quoted has to do with government attempt to apply recoupment against a taxpayer. Later in the same paragraph the language of the opinion says: "These provi-

sions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation."

Taxpayer makes a strong point of the fact that the McEachern decision and others since[10] have used the limitation of the sections quoted against the government only.[11] Not only does taxpayer point to the result of the decisions, but offers a reason for the application to government and not to taxpayer which appeals to us as having force. It has to do with the public policy involved in protecting taxpayers who pay taxes first and litigate their correctness later. If a taxpayer is advised that a tax is improperly assessed he should not be in a worse position if he pays and seeks refund than if he forced tax authorities to proceed against him. In the latter case, in the defense he makes, he will not have any question of an earlier tax, recovery of which is barred by the statute. Neither should he, if he pays the improperly imposed tax and seeks his money back.[12]

No such considerations apply to a defending taxpayer if his case comes within the equitable principles of recoupment. Such limitations, then, as the quoted sections impose are applicable to government and not to taxpayer. The public policy in inducing prompt payment of taxes is stronger than preservation to the government of its equitable rights of recoupment. We think this theory is sound and we accept it.

134 There is a further reason for rejecting the application of §§ 608 and 609 to this case and which was adopted by the court below upon the authority of West Va. Pulp and Paper Co. v. McElligott, 40 F. Supp. 765 (D. C. S. D. N. Y. 1941). It is to the effect that the right to recoupment is a substantive right, and that the right vested when the taxes were improperly exacted, back in 1919–1922. The statute in question came years later. It should not be interpreted retroactively to cut off vested rights. Government's attempt to distinguish the cited case appears to us unconvincing. We think the limitation of the statute to cases where the taxpayer's right arose after its passage is probably right, though the application to government and not to taxpayer seems to us a more compelling reason for the taxpayer's position in this case. At any rate, we have no doubt of the correctness of the District Court's conclusion on this point.

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[10] American Light & Traction Co. v. Harrison, 142 F. (2d) 639 (C. C. A. 7, 1944); Loeb v. Hoey, 112 F. (2d) 4 (C. C. A. 2, 1940); Penn et al v. Robertson, 29 F. Supp. 386 (D. C. M. D. N. C. 1939); Crawford et al v. Hiner, 23 F. Supp. 240 (D. C. W. D. Pa. 1938).

[11] The paper quoted above, "Recoupment in Federal Taxation," treats the problem of these sections as wholly a question of what obstacle they present to application of the doctrine of recoupment by the government. See p. 582 of 28 Va. L. Rev.

[12] See, along this line, "Estoppel and Recoupment in Federal Taxation * * *" 1939), 52 Harv. L. Rev. 496.

IS THIS SUIT AGAINST THE WRONG COLLECTOR?

Finally, the government says that the taxpayer may not recover by recoupment, tax money which he alleges was illegally collected by another collector than the party to this action. There is no dispute about the general proposition of law behind this argument, especially in view of its latest discussion in United States v. Kales, 314 U. S. 186 (1941). We do not think it applies to this litigation.

Literally this lawsuit was brought against Walter J. Rothensies, the collector to whom the plaintiff paid its money for 1935 tax. But as pointed out earlier in this opinion, our analysis of the legal problem is made clearer if we think of this suit as one brought by the United States to recover the alleged deficiency in the 1935 income tax of the taxpayer. In that suit the defendant seeks to recoup the tax payments it made, but which it could not collect because of the lapse of time. Is this recoupment claim an action against a collector, so that a taxpayer's recoupment will depend upon the continuity in office of the same individual as collector? That could be the law, but one does not reach such an unnatural conclusion unless forced to do so.

135

We think the answer is this: a collector is collecting the government's claim, not his own. Its source is the taxing statute and when the money is collected it goes to the public treasury. If he has improperly collected money, the taxpayer has the common law right to sue him as an individual to get it back. But that does not make the tax receipts collector's individual property, nor his claim against a taxpayer a personal claim of his own. We see no difficulty in a taxpayer's setting up, if proceedings were brought by public authorities, a recoupment claim for taxes paid a predecessor of the present collector. This conclusion is supported by a technical make-weight, justified because of the highly technical nature of the government's argument on this point. Recoupment, unlike statutory set-off and counterclaim, allows for no affirmative judgment for one who successfully asserts it. It is a shield not a sword. The most it can do is to protect one against a recovery by an opponent. A recoupment claim in a tax case is not a suit against a collector at all, but only a defense against what the collector asserts. If this is technical, it is no more so than the argument which it answers.

In a supplemental memorandum the government raises a point first made in oral argument before this Court. It points out that the additional income and excess profits tax for 1935 was not paid until 1938. At that time the taxpayer paid the principal sum with the interest which had then accrued. This is what it now seeks to get back. The government's argument is that apart from statute

or contract, interest cannot be recovered against the government on the part of a successful claimant. We have no reason now to go into the limits, if any, of the proposition urged. It is quite clear that it has nothing to do with the case. The taxpayer is not seeking interest on an amount which it paid the government, but is seeking to get back cash which it paid. That part of this
136 cash was principal sum and part of it was interest does not change the matter. It is not seeking interest on the cash that it paid, but just to get that cash back.

The point arose because the taxpayer's recoupment claim, while more than sufficient to take care of the principal amount assessed as additional tax in 1935, is not quite large enough to cover both that amount and the interest accrued on it. But the recoupment claim need only counterbalance the principal amount of tax. For if it does then no tax was owing and consequently no interest could rightfully accrue to the government on it. The government cannot keep the interest on late payment of a tax which the taxpayer did not have to pay. The orginal recoupment claim is relevant only in determining whether the tax had to be paid. Since it did not, both it and the interest paid on it may be recovered.

The conclusion is that the District Court was right and the judgment is affirmed.

137. In the United States Circuit Court of Appeals for the Third Circuit

October Term, 1945

No. 8836

The Electric Storage Battery Company

v.

Walter J. Rothensies, Individually and as Collector of Internal Revenue, appellant

Judgment

Filed Nov. 27, 1945

Present: Albert Lee Stephens, Maris and Goodrich, Circuit Judges.

On appeal from the District Court of the United States, for the Eastern District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

By the Court.

GOODRICH,
Circuit Judge.

NOVEMBER 27, 1945.

(File endorsement omitted.)

138 [Clerk's Certificate to foregoing transcript omitted in printing.]

139 Supreme Court of the United States

Order allowing certiorari

Filed March 25, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Jackson took no part in the consideration or decision of this application.

140 In the Supreme Court of the United States

Stipulation as to printed record

Filed April 2, 1946

Subject to this Court's approval, it is hereby stipulated and agreed by and between the attorneys for the parties above-named that, for purposes of the writ of certiorari, the printed record shall consist of the following:

(1) Docket entries.
(2) Complaint and Exhibits A, B and C attached thereto.
(3) Answer.
(4) Stipulation of counsel as to Amendment to Answer.
(5) Amendment to Answer.
(6) Agreed statement of facts.
(7) Plaintiff's Requests for Findings of Fact and Conclusions of Law.

(8) Defendant's Requests for Findings of Fact and Conclusions of Law.
(9) Opinion, Findings and Conclusions of District Court.
(10) Judgment of District Court.
(11) Certificate of Probable Cause.
(12) Notice of Appeal.
141 (13) Proceedings in Circuit Court of Appeals.
(14) This stipulation.

J. Howard McGrath,
J. HOWARD MCGRATH,
Solicitor General of the United States,
For the Petitioner.

Norris, Lex, Hart & Eldredge,
NORRIS, LEX, HART & ELDREDGE,
By: LAWRENCE W. ELDREDGE,
For the Respondent.

Dated this 27th day of March, 1946.

(Endorsement on cover:) File No. 50595. U. S. Circuit Court of Appeals, Third Circuit. Term No. 892. Walter J. Rothensies, Individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, Petitioner vs. The Electric Storage Battery Company, a Corporation. Petition for writ of certiorari and exhibit thereto. Filed February 26, 1946. Term No. 892 O. T. 1945.

U. S. GOVERNMENT PRINTING OFFICE: 1946

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CLERK

No. [redacted] 48

In the Supreme Court of the United States

OCTOBER TERM, 1945

WALTER J. ROTHENSIES, INDIVIDUALLY, AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	3
Statement	3
Specification of errors to be urged	6
Reasons for granting the writ	7
Conclusion	13
Appendix	14

CITATIONS

Cases:	
American Light & Traction Co. v. *Harrison*, 142 F. 2d 639	8
Bull v. *United States*, 295 U. S. 247	8
Commissioner v. *Gooch Co.*, 320 U. S. 418	8
Dixie Margarine Co. v. *Commissioner*, 115 F. 2d 445	8
Hall v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664	11, 12
Lynchburg Coal & Coke Co. v. *United States*, 47 F. Supp. 916	11
McEachern v. *Rose*, 302 U. S. 56	8, 12
Routzahn v. *Willard Storage Battery Co.*, 291 U. S. 386	5
Stone v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777	8
United States v. *Kales*, 314 U. S. 186	12, 13
United States v. *Nunnally Investment Co.*, 316 U. S. 258	13
Statutes:	
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 607	14
Sec. 608	11, 14
Sec. 609	11, 15
Sec. 610	15
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 503	14
Revised Statutes:	
Sec. 3226	11, 16
Sec. 3228	11, 16
Miscellaneous:	
109 A. L. R. 1354	8
130 A. L. R. 838	8
154 A. L. R. 1052	8
The Doctrine of Recoupment in Federal Taxation, 28 Va. L. Rev. 577	8

684239—46

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. —

WALTER J. ROTHENSIES, INDIVIDUALLY, AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Walter J. Rothensies, individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered November 27, 1945, affirming the judgment of the District Court of the United States for the Eastern District of Pennsylvania.

OPINIONS BELOW

The opinion of the District Court (R. 5a) is reported in 57 F. Supp. 731. The opinion of the Circuit Court of Appeals (R. 2) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1945. (R. 9.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer in 1935 received a refund of excise taxes for periods from July 1922 to April 1926, and thereafter paid income taxes for the year 1935 with respect to that refund. Those income taxes were held herein to have been properly imposed. Nevertheless, the courts below awarded the taxpayer a refund of those 1935 income taxes from the Collector of Internal Revenue to whom they were paid, on the ground that similar excise taxes which the taxpayer had erroneously paid to predecessor Collectors for periods between 1919 and 1922 (the refund of which had been barred by limitations) should have been offset against the 1935 income taxes on the principle of recoupment. The questions presented are:

(1) Whether equitable principles of recoupment are applicable.

(2) Whether in any event Sections 608–610 of the Revenue Act of 1928 preclude a recoupment of the barred excise taxes.

(3) Whether in this suit against the Collector for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to this Collector's predecessors in office.

STATUTES INVOLVED

The pertinent provisions of the statutes involved are set out in the Appendix, *infra*, pp. 14–17.

STATEMENT

The facts as stipulated (R. 18a–21a; T. 51–86)[1] and as found by the District Court (R. 17a; T. 87–99, 114) may be summarized as follows:

During the period between April 28, 1919, and June 27, 1922, inclusive, the taxpayer paid excise taxes on sales of storage batteries, of which amounts the sum of $95,098.06 was subsequently refunded, leaving a net amount of $912,978.57 for which no claim for refund was ever filed or allowed (R. 18a, 19a). The excise taxes so paid were taken as deductions by the taxpayer in its federal income tax returns for the years 1919 to 1922, inclusive, and through the deduction thereof tax-

[1] For purposes of the petition for certiorari, an abbreviated record, consisting of the printed record below plus the proceedings in the court below, has been filed. The reference "R." is to the printed record; the reference "T." is to volume 1 of the typewritten transcript on file in the Court.

payer secured a substantial tax benefit. (R. 20a.) During such period the taxpayer made monthly returns of excise taxes in which it reported sales of its storage batteries and it paid such excise taxes to the then Collectors of Internal Revenue for the First District of Pennsylvania, who were the predecessors in office of the Collector named in this suit. (R. 18a.)

During the period between July 1922, and April 1926, inclusive, the taxpayer paid excise taxes in the amount of $825,151.52 on sales of storage batteries (T. 52–53), which excise taxes were taken as deductions in the taxpayer's income tax returns for the years 1922 to 1926, inclusive, and so resulted in a tax benefit to it of $139,668.83, exclusive of interest, or the sum of $305,335.07, including interest to June 5, 1944 (T. 54). On July 19, 1926, the taxpayer filed a timely claim for refund of the excise taxes paid in the amount of $825,151.52 for the period between 1922 and 1926. (T. 55.) Following the rejection of its claim for refund, the taxpayer instituted suit in the United States District Court for the Eastern District of Pennsylvania against the then Collector of Internal Revenue, and secured a judgment in that court for a refund of $1,416,567.81, and in 1933 the Circuit Court of Appeals for the Third Circuit affirmed the judgment. (T. 55–57.) The Government subsequently declined to pay the judgment on the ground that the taxpayer had not established that it had borne the burden of the

tax, and that under the decision in the case of *Routzahn* v. *Willard Storage Battery Co.*, 291 U. S. 386, no recovery was allowable. (T. 57–58.) However, after prolonged negotiations the taxpayer agreed in 1935 to accept the payment of $1,395,515.35 of which $825,151.52 represented tax, and the balance represented interest. (T. 58.) In its income tax return for the year 1935 the taxpayer reported as income only the portion of the interest accrued on the refund of excise taxes during the year 1935. (T. 58–59.) The Commissioner of Internal Revenue held that the refund of tax in the amount of $825,151.52 and the whole amount of interest thereon was taxable as income for the year 1935 and accordingly assessed an additional income and excess profits tax against the taxpayer for that year, which, together with interest, amounted to $229,805.34. (T. 59.) After payment of such income and excess profits tax deficiency, together with interest, the taxpayer filed a timely claim for refund thereof, and upon the rejection of its claim, this suit was instituted. (T. 60.) The taxpayer contended in its claim for refund and in its suit that the amounts added by the Commissioner to its taxable income for the year 1935 were not income at all and if they were, it could not be taxed therefor in the year 1935; and, in the alternative, it maintained that if the assessment of the additional taxes for the year 1935 was correct, then it should be permitted to recoup the amount of the excise taxes collected

from it between 1919 and 1922. (T. 69–84; T. 3–12.)

The District Court held that the deficiency in 1935 income and excess profits tax was properly assessed and collected, but that the taxpayer had a right to recoupment equal to the amount of the excise taxes collected from it between 1919 and 1922, less the tax benefit derived from the deduction of such excise taxes in its income tax returns for the years 1919 to 1922, inclusive, including interest. Accordingly, the District Court rendered judgment for the amount sued for plus interest. (R. 4a–17a.)

The Circuit Court of Appeals affirmed the judgment of the District Court, agreeing with that court that the deficiency in 1935 income and excess profits tax was properly assessed but that the taxpayer had a right to recoup the barred excise taxes for the years 1919 to 1922. (R. 2–10.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that, in the suit for refund of income taxes for 1935 properly imposed upon a refund of excise taxes erroneously paid on sales of storage batteries, the taxpayer may recoup excise taxes erroneously paid in earlier periods on other sales of storage batteries, the refund of which is barred by the statute of limitations.

(2) In holding that excise taxes erroneously paid on sales of storage batteries over the periods from 1919 to 1922 arose out of the same transaction within the principle of recoupment as income taxes imposed on the refund of similar excise taxes erroneously paid for later years.

(3) In holding that the limitations in the Revenue Act of 1928 are applicable only to the Government and do not preclude the taxpayer from recouping the barred excise taxes in the suit for refund of income taxes.

(4) In holding that the right to recoupment is a substantive right which vested in the taxpayer when the excise taxes were paid in the years 1919 to 1922, and that Sections 608 and 609 should not be interpreted to cut off this right.

(5) In holding that, in the suit against a Collector of Internal Revenue for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to that Collector's predecessors in office.

(6) In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

1. The question of the scope of the principle of recoupment in suits for the recovery of federal taxes arises frequently and considerable confusion and a certain amount of basic inconsis-

tency now exist among the decisions.[2] It would be in the public interest to have the matter clarified. The decision of the court below in the present case is believed to be incorrect and to create additional and undesirable uncertainties in this field.

A large portion of the present confusion is due to the difficulties in reconciling and applying the decisions of this Court in *Bull* v. *United States*, 295 U. S. 247, and *Stone* v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777, on the one hand, and *McEachern* v. *Rose*, 302 U. S. 56, on the other.

In the present case, the court below held that the recoupment doctrine announced in the *Bull* case was applicable, although stating that the main claim and the recoupment claim were more closely connected in the *Bull* case than they are here.[3]

The decision below in this respect constitutes an unwarranted extension of the principle of the

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[2] In the opinion of the dissenting judge in *American Light & Traction Co.* v. *Harrison*, 142 F. 2d 639, 644 (C. C. A. 7th), it is said: "The situation as it now exists, is vexatious, perplexing, and confusing." See also The Doctrine of Recoupment in Federal Taxation, 28 Va. L. Rev. 577 (1941–1942); and notes in 109 A. L. R. 1354, 130 A. L. R. 838 and 154 A. L. R. 1052.

[3] The court below relies also upon *Dixie Margarine Co.* v. *Commissioner*, 115 F. 2d 445 (C. C. A. 6th). That was an appeal from the Board of Tax Appeals. In *Commissioner* v. *Gooch Co.*, 320 U. S. 418, this Court held that the Board had no jurisdiction to consider defenses based upon recoupment.

Bull case. Under the *Bull* decision, a recoupment claim, to be sustained, must arise out of some feature of the transaction upon which the main action is grounded. Here the main action was for income taxes for the year 1935, held by the court below to have been properly imposed. It is true that these income taxes were imposed upon a refund of excise taxes, but the excise taxes refunded were for the periods between 1922 and 1926. During those four years the taxpayer had secured a tax benefit, by virtue of deducting the excise taxes in its returns for those years, which, with interest, roughly approximated the income taxes, with interest, imposed upon the refund of the excise taxes. The income taxes imposed in 1935 related in no respect to anything which had occurred prior to June 1922.

The court below stated, however, that it saw no reason for "hedging the 'transaction' part of the requirement of the *Bull* case within close quarters, especially where * * * there is a logical connection between main claim and recoupment claim." (R. 5.) The logical connection between the main claim in the present case and the recoupment claim exists, the court held (R. 4), in the fact that the barred excise taxes for the periods from April 1919 to June 1922 sought to be recouped were the same type of tax imposed upon the same nature of merchandise sold as the excise taxes for the later periods, the subsequent refund of which gave rise to the income tax.

Concededly the taxpayer could not have joined a claim for the excise taxes for the periods from 1919 to June 1922 in the suit which it brought in 1928 against the then Collector of Internal Revenue for refund of the excise taxes for the periods from June 1922 to February 1926, because even in 1928 suit for the earlier years was barred through failure to file a timely claim for refund for those years. By sustaining the recoupment claim in the present case, the court below has permitted the taxpayer to accomplish indirectly what it could not do directly. Indeed, there would be less excuse for permitting a recovery of the barred excise taxes for 1919 to 1922 in the present suit for income taxes for 1935 than in the earlier suit for refund of the excise taxes for 1922 to 1926, for the income taxes were imposed upon the *refund* of the excise taxes for the later years and therefore the relationship of the income tax to the excise taxes for the earlier years is one step farther removed.

We submit that the only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. If the recoupment principle is to be applied to distinct transactions merely because they grow out of earlier transactions which were simi-

lar but not related, the scope of the principle is of wider compass than has been generally understood.

The radical extension by the court below of the theory of what constitutes the same transaction for recoupment purposes is of such far-reaching consequences, we submit, as to call for review by this Court.

2. In the District Court and in the court below, the Collector contended that in any event recoupment was barred by Section 608 and Section 609 (b) of the Revenue Act of 1928. (Appendix, *infra*.) The holding of the court below rejecting this contention is in direct conflict with the decisions of the Court of Claims in *Hall* v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664, and *Lynchburg Coal & Coke Co.* v. *United States*, 47 F. Supp. 916.

Under Revised Statutes, Section 3228, as amended (Appendix, *infra*), claims for refund of the excise taxes for the periods 1919 to 1922 could not have been filed later than 1926, but no claim was ever filed, and consequently, under Revised Statutes, Section 3226 (Appendix, *infra*), no suit could be maintained for such taxes. Under Sections 608 and 609 (b), a refund of those taxes, after the statute of limitations had run in 1926, would have constituted an erroneous refund which the United States could have recovered under Section 610, and a credit of the overpayment against the income taxes for 1935 would have been void.

In similar circumstances, the Court of Claims, applying the reasoning of this Court in *McEachern* v. *Rose*, 302 U. S. 56, held in the above entitled cases that recoupment was barred by Sections 608 and 609 (b).[4]

3. The holding of the court below that the taxpayer may, in the suit against Collector Rothensies, recoup taxes paid to the Collector's predecessors in office, conflicts in principle with the decision of this Court in *United States* v. *Kales*, 314 U. S. 186. In that case this Court said (pp. 199–200):

> It was payment to the collector which gave rise to the suit against him and limited the amount of the recovery. The judgment against the collector is a personal judgment, to which the United States is a stranger except as it has obligated itself to pay it. * * *
>
> * * * * * *
>
> By no possibility could the respondent in the suit brought against Collector Woodworth in 1925 recover taxes paid to Collector Grogan in 1920, which she demands here. * * *

In the present case the income taxes for 1935 which were paid to Collector Rothensies were, as held below, correctly determined and assessed

[4] In the *Hall* case, the Government filed a memorandum stating that it would welcome a reexamination of *McEachern* v. *Rose* and that it did not oppose certiorari if the writ were granted for that purpose.

against the taxpayer. The excise taxes for 1919 to 1922 sought to be recovered by way of recoupment were paid to the Collector's predecessors in office. Collector Rothensies was a stranger to the payment of the excise taxes. The effect of the decision below is to allow a personal judgment against one Collector because of payments made to another Collector.[5]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.

FEBRUARY, 1946.

[5] Both in the *Kales* case and in *United States* v. *Nunnally Investment Co.*, 316 U. S. 258, the Government attacked the doctrine that a suit against the collector is "personal" today, but the Court rejected the contention. In the circumstances, the Government accepts the doctrine, which plainly forbids a refund from a collector, whether through recoupment, offset, or other procedural device, on account of taxes paid to a different collector.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 607. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.

SEC. 608. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST TAXPAYER.[5]

A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or

(b) in the case of a claim filed within the proper time and disallowed by the Commissioner after the enactment of this Act, if the refund was made after the expiration of the period of limitation for filing suit, unless—

(1) within such period suit was begun by the taxpayer, or

[5] The last sentence of Section 608 (b) (2) of the Revenue Act of 1928 was added by Section 503 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

(2) within such period, teh taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named cases then pending before the United States Board of Tax Appeals or the courts. If such agreement has been entered into, the running of such statute of limitations shall be suspended in accordance with the terms of the agreement.

SEC. 609. ERRONEOUS CREDITS.

(a) *Credit against barred deficiency.*—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

(b) *Credit of barred overpayment.*—A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608.

(c) *Application of section.*—The provisions of this section shall apply to any credit made before or after the enactment of this Act.

SEC. 610. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

(a) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 608, after the enactment of this Act, may be recovered by suit brought in the name of the United States, but only if such suit is begun within two years after the making of such refund.

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which

has been erroneously refunded (if such refund would not be considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later.

Revised Statutes:

SEC. 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of [*the*] Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought, without first having a decision of the Commissioner at any time within the period limited in the next section.

SEC. 3228 [as amended by the Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 1112; Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 619 (c); Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1106 (a)]. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any

sum alleged to have been excessive or in any manner wrongfully collected must, except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum. The amount of the refund (in the case of taxes other than income, war-profits, excess-profits, estate, and gift taxes) shall not exceed the portion of the tax, penalty, or sum paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

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No. 48

In the Supreme Court of the United States

OCTOBER TERM, 1946

WALTER J. ROTHENSIES, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	3
Statement	3
Specification of errors to be urged	6
Summary of argument	7
Argument:	
I. Recovery by the taxpayer in this case may not be supported upon equitable principles of recoupment	10
1. There is no statutory authority for the allowance of a refund here on equitable principles	12
2. The doctrine of *Bull* v. *United States* is inapplicable because the barred excise taxes for 1919–1922 did not arise out of the same transaction as the income taxes for 1935 and because recovery of the excise taxes was barred when the Commissioner proceeded to collect the income tax	18
II. Recoupment of the barred excise taxes is, in any event, precluded by Sections 608–610 of the Revenue Act of 1928	30
III. In this suit against Collector Rothensies for refund of taxes paid to him, the taxpayer may not recoup excise taxes paid to this Collector's predecessors in office	39
Conclusion	41
Appendix	42

CITATIONS

Cases:

American Light & Traction Co. v. *Harrison*, 142 F. 2d 639	35
Angelus Milling Co. v. *Commissioner*, 325 U. S. 293	15
Bull v. *United States*, 295 U. S. 247	8, 17, 18, 19, 21, 22, 23, 27, 34, 37
Cheatham v. *United States*, 92 U. S. 85	17
Clayton Magazines, In re, 77 F. 2d 852	28
Crawford v. *Heiner*, 23 F. Supp. 240	35
Crozzett Lumber Co. v. *United States*, 87 F. 2d 930	27
Dakin v. *Bayly*, 290 U. S. 143	40
Dixie Margarine Co. v. *Commissioner*, 115 F. 2d 445	28
Dobson v. *Commissioner*, 320 U. S. 489	11, 21, 22
Dunigan v. *United States*, 23 F. Supp. 467	27
First Nat. Bank of Birmingham v. *United States*, 12 F. Supp. 301	27
Freihofer Baking Co. v. *Commissioner*, 151 F. 2d 383	11

Cases—Continued

	Page
Gooch Milling & Elevator Co. v. *Commissioner*, 133 F. 2d 131, reversed, 320 U. S. 418	21, 27, 29
Graham & Foster v. *Goodcell*, 282 U. S. 409	17
Griffiths v. *Commissioner*, 308 U. S. 355	11
Hall v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664	32
Hoboken Land & Improvement Co. v. *Commissioner*, 46 B. T. A. 495, affirmed, 138 F. 2d 104	11
Houbigant, Inc. v. *Commissioner*, 31 B. T. A. 954, affirmed 80 F. 2d 1012, certiorari denied, 298 U. S. 669	11
Lesnik v. *Public Industrial Corp.*, 144 F. 2d 968	24
Longyear Realty Corp. v. *Kavanagh*, decided July 8, 1946	20, 27
Lyeth v. *Hoey*, 112 F. 2d 4	35
Lynchburg Coal and Coke Co. v. *United States*, 47 F. Supp. 916	32
McCaughn v. *Electric Storage Battery Co.*, 63 F. 2d 715	4
McEachern v. *Rose*, 302 U. S. 56	9, 33, 34, 38
Mills v. *United States*, 35 F. Supp. 738	27
Moore v. *New York Cotton Exchange*, 270 U. S. 593	24
Moore Ice Cream Co. v. *Rose*, 289 U. S. 373	16
Pennsylvania R. Co. v. *Miller*, 124 F. 2d 160, certiorari denied, 316 U. S. 676	19
Rock Island R. R. Co. v. *United States*, 254 U. S. 141	14
Rotenberg v. *Sheehan*, 48 F. Supp. 584	35
Routzahn v. *Willard Storage Battery Co.*, 291 U. S. 386	4
Stone v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777	21, 22, 23, 27, 34
Stow v. *Yarwood*, 14 Ill. 424	19
Tozaway Mills v. *United States*, 61 C. Cls. 363	36
Union Trust Co. v. *Commissioner*, 39 B. T. A. 338, affirmed, 111 F. 2d 60, certiorari denied, 311 U. S. 658	11
United States v. *Felt & Tarrant Co.*, 283 U. S. 269	14
United States v. *Garbutt Oil Co.*, 302 U. S. 528	14
United States v. *Jefferson Electric Co.*, 291 U. S. 386	13, 16
United States v. *Kales*, 314 U. S. 186	39, 40, 41
United States v. *Nunnally Investment Co.*, 316 U. S. 258	39, 41
Utilities Service v. *Walker*, 78 F. 2d 18	24
West Virginia Pulp & Paper Co. v. *McElligott*, 40 F. Supp. 765	27
Wheat v. *Dotson*, 12 Ark. 699	19
Williams v. *Neely*, 134 Fed. 1	19
Wilson v. *Codman's Ex'r*, 3 Cranch 193	40
Statutes:	
Internal Revenue Code, Sec. 3772 (26 U. S. C. 3772)	39
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 900	12
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 900	12
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 600	12
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 1106	35, 36

Statutes—Continued	Page
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 424	16
Sec. 607	33, 34, 35, 42
Sec. 608	16, 31, 34, 35, 42
Sec. 609	16, 31, 33, 34, 35, 43
Sec. 610	31, 35, 43
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 503	42
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 820	25, 26, 44
Revenue Act of 1942, c. 619, 56 Stat. 798:	
Sec. 116 (26 U. S. C. Supp. V, Sec. 22)	12
Sec. 503 (26 U. S. C. Supp. V, Sec. 3772)	39
Revised Statutes:	
Sec. 3182	16
Sec. 3226	13, 31, 49
Sec. 3228	12, 31, 50
Miscellaneous:	
Counterclaims, 37 Yale L. J. 300 (1927–1928)	19
Doctrine of Recoupment in Federal Taxation, The, 28 Va. L. Rev. 577 (1941–1942)	19
House Hearings on Revenue Revision 1927–28, 69–70th Congresses:	
Pp. 148–152	25
Pp. 161–162	25
Pp. 302–303	25
Pp. 307–308	25
Pp. 534–535	25
Pp. 544–545	25
Pp. 547–548	25
Pp. 576–577	25
House Hearings on Revenue Revision 1934, 73d Cong., 2d Sess., p. 132	25
H. Rep. No. 356, 69th Cong., 1st Sess., p. 55 (1939–1 Cum. Bull. (Part 2) 361, 380)	36
H. Rep. No. 2, 70th Cong., 1st Sess., pp. 33–34 (1939–1 Cum. Bull. (Part 2) 384, 406)	35
1 Moore's Federal Practice Under the New Federal Rules 682–684	24
Restatement, Judgments 217	20
S. Rep. No. 1567, 75th Cong., 3d Sess., p. 49 (1939–1 Cum. Bull. (Part 2) 779, 815)	25
Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509–532, 719–778 (1939)	26
Statute of Limitations, 27 Cal. L. Rev. 109–156 (1938–1939)	26
Tax Refund Claims and the Statute of Limitations, 1 Tax Law Review 45 (1945)	20
Waterman, Set-Off and Recoupment (1869) 465–478	20

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 37) is reported in 57 F. Supp. 731. The opinion of the Circuit Court of Appeals (R. 48) is reported in 152 F. 2d 521.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1945. (R. 55.) The petition for a writ of certiorari was filed on February 26, 1946, and was granted on March

25, 1946. (R. 56, 57.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer in 1935 received a refund of excise taxes for periods from July, 1922, to April, 1926, and thereafter paid income taxes for the year 1935 with respect to that refund. Those income taxes were held herein to have been properly imposed. Nevertheless, the courts below awarded the taxpayer a refund of those 1935 income taxes from the Collector of Internal Revenue to whom they were paid, on the ground that similar excise taxes which the taxpayer had erroneously paid to predecessor Collectors for periods between 1919 and 1922 (the refund of which had been barred by limitations as early as 1926) should have been offset against the 1935 income taxes on the principle of recoupment. The questions presented are:

(1) Whether equitable principles of recoupment are applicable.

(2) Whether in any event Sections 608–610 of the Revenue Act of 1928 preclude a recoupment of the barred excise taxes.

(3) Whether in this suit against the Collector for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to this Collector's predecessors in office.

STATUTES INVOLVED

The pertinent provisions of the statutes involved are set out in the Appendix, *infra*, pp. 42–50.

STATEMENT

The facts as stipulated (R. 21–29) and as found by the District Court (R. 30–36, 45) may be summarized as follows:

During the period between April 28, 1919, and June 27, 1922, inclusive, the taxpayer paid excise taxes on sales of storage batteries in the net amount of $912,978.57 for which no claim for refund was ever filed or allowed. (R. 27, 28–29.) The excise taxes so paid were taken as deductions by the taxpayer in its federal income tax returns for the years 1919 to 1922, inclusive, and through the deduction thereof taxpayer secured a substantial tax benefit. (R. 28, 29.) During such period the taxpayer made monthly returns of excise taxes in which it reported sales of its storage batteries and it paid such excise taxes to the then Collectors of Internal Revenue for the First District of Pennsylvania, who were the predecessors in office of Walter J. Rothensies, the Collector named in this suit. (R. 27.)

During the period between July, 1922, and April, 1926, inclusive, the taxpayer paid similar excise taxes in the amount of $825,151.52 on sales of storage batteries, which excise taxes were taken as deductions in the taxpayer's income tax returns for the years 1922 to 1926, inclusive, and so re-

resulted in a tax benefit to it of $139,668.83, exclusive of interest, or the sum of $305,335.07, including interest to June 5, 1944.[1] (R. 22, 23.) On July 19, 1926, the taxpayer filed a timely claim for refund of the excise taxes paid in the amount of $825,151.52 for the period between 1922 and 1926. (R. 23.) Following the rejection of its claim for refund, the taxpayer instituted suit in the United States District Court for the Eastern District of Pennsylvania against the then Collector of Internal Revenue, and secured a judgment in that court for a refund of $1,416,567.81, and in 1933 the Circuit Court of Appeals for the Third Circuit affirmed the judgment. *McCaughn* v. *Electric Storage Battery Co.*, 63 F. 2d 715. (R. 23–25, 31.) The Government subsequently declined to pay the judgment on the ground that the taxpayer had not established that it had borne the burden of the tax, and that under the decision in the case of *Routzahn* v. *Willard Storage Battery Co.*, 291 U. S. 386, no recovery was allowable. (R. 25.) However, after prolonged negotiations the taxpayer agreed in 1935 to accept the payment of $1,395,515.35 of which $825,151.52 represented tax, and the balance represented interest. (R. 25, 31.)

In its income tax return for the year 1935 the taxpayer reported as income only the portion of

[1] June 5, 1944 was the date of the stipulation of facts herein upon the basis of which the District Court made its findings (R. 29). It has no other significance.

the interest accrued on the refund of excise taxes during the year 1935. (R. 25.) The Commissioner of Internal Revenue held that the refund of tax in the amount of $825,151.52 and the whole amount of interest thereon was taxable as income for the year 1935 and accordingly assessed an additional income and excess profits tax against the taxpayer for that year, which, together with interest, amounted to $229,805.34. (R. 26.) On December 5, 1938, the taxpayer paid that deficiency and interest, and on November 30, 1940, it filed a claim for refund. Upon the rejection of its claim, it brought this suit against Collector Rothensies who was the Collector in 1938 at the time the deficiency was paid. (R. 21, 26.) The taxpayer contended in its claim for refund and in its suit that the amounts added by the Commissioner to its taxable income for the year 1935 were not income at all and if they were, it could not be taxed therefor in the year 1935; and, in the alternative, it maintained that if the assessment of the additional taxes for the year 1935 was correct, then it should be permitted to recoup the amount of the excise taxes collected from it between 1919 and 1922. (R. 2–7, 9–16.)

The District Court held that the deficiency in 1935 income and excess profits tax was properly determined and assessed, but that the taxpayer had a right to recoupment equal to the amount of the excise taxes collected from it between 1919

and 1922, less the tax benefit derived from the deduction of such excise taxes in its income tax returns for the years 1919 to 1922, inclusive, including interest. Accordingly, the District Court rendered judgment for the amount sued for plus interest. (R. 37–45.)

The Circuit Court of Appeals affirmed the judgment of the District Court, agreeing with that court that the deficiency in 1935 income and excess profits tax was properly assessed but that the taxpayer had a right to recoup the barred excise taxes for the years 1919 to 1922. (R. 48–56.)

SPECIFICATIONS OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that, in the suit for refund of income taxes for 1935 properly imposed upon a refund of excise taxes erroneously paid on sales of storage batteries, the taxpayer may recoup excise taxes erroneously paid in earlier periods on other sales of storage batteries, the refund of which is barred by the statute of limitations.

(2) In holding that excise taxes erroneously paid on sales of storage batteries over the periods from 1919 to 1922 arose out of the same transaction within the principle of recoupment as income taxes imposed on the refund of similar excise taxes erroneously paid for later years.

(3) In holding that the limitations in the Revenue Act of 1928 are applicable only to the Gov-

ernment and do not preclude the taxpayer from recouping the barred excise taxes in the suit for refund of income taxes.

(4) In holding that the right to recoupment is a substantive right which vested in the taxpayer when the excise taxes were paid in the years 1919 to 1922, and that Sections 608 and 609 should not be interpreted to cut off this right.

(5) In holding that, in the suit against a Collector of Internal Revenue for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to that Collector's predecessors in office.

(6) In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

I

The court below in sustaining a recovery by the taxpayer of correctly determined and assessed income taxes for the year 1935 upon the ground that the taxpayer was entitled to a recoupment of excise taxes, which were not legally refundable because of the statute of limitations, has granted relief to the taxpayer not permitted under the statutory scheme for the recovery of taxes.

The system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes requires that all claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously assessed or collected be presented to the Commissioner of Internal Revenue within a prescribed period of

time and prohibits the refunding or crediting of such taxes or the bringing of suit therefor unless claim is filed within the period prescribed.

In this case the recovery by the taxpayer of the excise taxes for the period from 1919 to June 1922, which the taxpayer seeks to recoup, is barred by the statute of limitations inasmuch as the taxpayer has never filed a claim for refund or credit of those taxes, and the time within which such a claim could be filed has long since expired. Indeed, the refund of the 1919–1922 excise taxes had been barred even before July 19, 1926 when the taxpayer filed its claim for refund of its 1922–1926 excise taxes.

The court below has held that the income taxes for 1935, which are the only taxes that the present suit purportedly seeks to recover, were correctly determined and assessed. There is no provision of law requiring or permitting the Commissioner or the Collector to reduce a correct assessment of taxes by the amount of an overpayment of taxes which is barred from refund or credit by the statute of limitations, and accordingly the Collector was under a statutory duty to collect the assessment of 1935 income taxes. The determination, assessment and collection of the 1935 income taxes were neither erroneous nor invalid, and such taxes may not be recovered by suit.

The doctrine of *Bull* v. *United States*, 295 U. S. 247, is inapplicable to this case because the barred excise taxes for 1919–1922, sought to be

recouped, did not arise out of the same transaction as the income taxes for 1935, and for the further reason that the claim to recover those taxes was not alive when proceedings were instituted to collect the 1935 tax. The income taxes for 1935 were imposed upon a refund of excise taxes for 1922 to 1926 for which a timely refund claim had been filed and suit brought. The only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. The recoupment principle is not to be applied to distinct transactions merely because they grow out of earlier transactions which were unrelated though similar.

II

In *McEachern* v. *Rose*, 302 U. S. 56, this Court held that Sections 607 and 609 (a) of the Revenue Act of 1928 precluded the Government from defeating a recovery of an overpayment of taxes by recoupment of a barred deficiency. If this Court adheres to that decision, then Sections 608 and 609 (b), which parallel Sections 607 and 609 (a), preclude the taxpayer from recovering a correctly assessed tax by recoupment of a barred overpayment of other taxes. There is no basis in the wording or the legislative history of Sections 607–609 to justify the conclusion of the court

below that the limitations apply only against the Government, nor is there any public policy which would warrant that conclusion. Whatever limitations are contained in those sections are not restricted to cases arising after the passage of the Revenue Act of 1928.

III

This Court has held that suits against Collectors of Internal Revenue are personal. The excise taxes which the taxpayer seeks to recoup were paid to the predecessors in office of the Collector against whom the present suit was brought. There has been strict compliance with the law by the Commissioner and by the Collector in respect of the 1935 income taxes sought to be recovered. In permitting a recovery of those taxes because of the erroneous collection of the excise taxes, the court below has allowed a personal judgment to be obtained against one Collector because of payments made to a different Collector, which is a result forbidden by this Court's decisions.

ARGUMENT

I

RECOVERY BY THE TAXPAYER IN THIS CASE MAY NOT BE SUPPORTED UPON EQUITABLE PRINCIPLES OF RECOUPMENT

The present suit by the taxpayer seeks the recovery of income taxes for the year 1935 imposed upon the refund in that year of excise taxes paid by the taxpayer from June 1922 to 1926 upon the

sale of storage batteries. The complaint sets forth two causes of action. The first cause of action (R. 2–6) alleges that the assessment of the 1935 income taxes was erroneous because the refund of the 1922–1926 excise taxes was not income and because the income, if any, other than a small amount of the interest, had not accrued in the year 1935. The second cause of action (R. 6–7), assuming the correctness of the 1935 income tax assessment, alleges that it is the right of the taxpayer to have set off or recouped against that assessment excise taxes paid on the sale of [redacted] from 1919 to June 1922, which could not be legally refunded because of the bar of the statute of limitations.

The court below has correctly held that the refund of the excise taxes in 1935 constituted income in that year to the taxpayer,[2] that the

[2] No issue is raised in the petition for certiorari with respect to the holding below that the refund constituted income to the taxpayer. The point is discussed in detail in the opinion of the District Court (R. 38–42), and the conclusion of that court, concurred in by the Circuit Court of Appeals, is plainly correct. *Houbigant, Inc.* v. *Commissioner*, 31 B. T. A. 954, affirmed, 80 F. 2d 1012 (C. C. A. 2d), certiorari denied, 298 U. S. 669; *Union Trust Co.* v. *Commissioner*, 39 B. T. A. 338, affirmed, 111 F. 2d 60 (C. C. A. 7th), certiorari denied, 311 U. S. 658; *Hoboken Land & Improvement Co.* v. *Commissioner*, 46 B. T. A. 495, 502–506, affirmed, 138 F. 2d 104 (C. C. A. 3d); *Freihofer Baking Co.* v. *Commissioner*, 151 F. 2d 383 (C. C. A. 3d); cf. *Griffiths* v. *Commissioner*, 308 U. S. 355, 357; *Dobson* v. *Commissioner*, 320 U. S. 489, 505. A benefit was derived by the taxpayer, through the deduction in its income tax returns for 1922 to 1926 of the excise taxes paid from June 1922 to 1926, which was approximately equal

income taxes sought to be recovered were properly determined and assessed, and accordingly that the taxpayer is not entitled to a recovery under its first cause of action.

However, the court has sustained, under the second cause of action, a recovery by the taxpayer of the income taxes in suit upon the theory that the taxpayer is entitled to recoup the barred excise taxes paid by it from 1919 to June 1922.[3] In thus sustaining recovery in this case we submit the court below has erred.

1. THERE IS NO STATUTORY AUTHORITY FOR THE ALLOWANCE OF REFUND HERE ON EQUITABLE PRINCIPLES

Section 3228 of the Revised Statutes, as amended (Appendix, *infra*, p. 50), provides that all claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously or illegally assessed or collected must (except as otherwise provided by law in the

to the income taxes imposed upon the refund of those excise taxes. (R. 23.) The income attributable to the recovery of the excise taxes may not, therefore, be excluded from gross income under the amendments to the Internal Revenue Code and prior Revenue Acts made by Section 116, Revenue Act of 1942, c. 619, 56 Stat. 798, 812.

[3] The excise taxes paid by the taxpayer over the periods from 1919 to 1926 were imposed under similar statutory provisions upon the basis that the electric storage batteries manufactured and sold by the taxpayer were automobile parts or accessories. Those paid from 1919 to June 1922 were under Section 900 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and the Revenue Act of 1921, c. 136, 42 Stat. 227; and those paid from June 1922 to 1926 were under Section 900 of the Revenue Act of 1921, *supra*, and Section 600 of the Revenue Act of 1924, c. 234, 43 Stat. 253. (R. 22, 27.)

case of income, war profits, excess profits, estate and gift taxes) be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax. That section further provides that the amount of the refund shall not exceed the portion of the tax paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

Section 3226 of the Revised Statutes (Appendix, *infra*, pp. 49–50) provides that no suit shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected until appeal shall have been duly made to the Commissioner of Internal Revenue according to the provisions of law in that regard.

These sections form part of a system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes. This system, developed through long years of experience, was intended to comprehend the entire subject, including all claims for refund. *United States* v. *Jefferson Electric Co.* 291 U. S. 386, 395, 396. The system was summarized in that case as follows (pp. 395–396):

> Anterior to collection the Commissioner possesses exclusive authority to revise, correct or reject assessments and the courts are forbidden to entertain suits "to re-

> strain the assessment or collection." After collection aggrieved taxpayers are accorded a limited time within which to apply for refunds, and the Commissioner is authorized to grant the applications where the taxes are shown to have been erroneous or illegal; but a denial by him is not final. If the application is either denied or not acted on by the Commissioner the taxpayer is accorded a fixed period within which to bring suit for a refund against the United States or the collector who received the tax, and if in the suit he establishes that the tax was erroneous or invalid, that it was paid by him, and that his claim has been duly and seasonably presented and prosecuted, he is entitled to judgment for a refund of the amount paid with interest.

The statutory requirement of the filing of a claim with the Commissioner as a prerequisite to suit was designed to protect the Government against stale demands and to secure an orderly administration of the revenue. The claim for refund which is required as a prerequisite to suit relates to the claim which may be asserted by the suit. Compliance with the statute, requiring the presentation of the claim within a given period of time, is mandatory and may not be waived by either the Collector or the United States. *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269; *Rock Island R. R. Co.* v. *United States*, 254 U. S. 141; *United States* v. *Garbutt Oil Co.*, 302

U. S. 528, 533–534; *Angelus Milling Co.* v. *Commissioner*, 325 U. S. 293, 296.

In the present case the latest date upon which a claim for refund could have been filed to recover any of the excise taxes for the periods from 1919 to June 1922 expired in 1926. Taxpayer never filed a claim for refund of those taxes, and no suit was instituted by it for the recovery of those taxes because of the bar of the statute of limitations. The refund of those taxes had been barred as early as July 1926 when the taxpayer filed its claim for the recovery of its excises for the period July 1922–April 1926. (R. 28–29.) Indeed, the taxpayer alleges in its complaint (R. 6–7) that the amount of those taxes for 1919 to 1922 was not legally refundable to it by reason of the fact that the statute of limitations intervened as a bar against the filing of claim for refund therefor.

The theory of taxpayer's second cause of action, sustained below, is that there was an illegal collection by Collector Rothensies of the income taxes for 1935 because no effect was given to the alleged right of recoupment of the barred 1919–1922 excise taxes. However, in 1938 when the 1935 deficiency was collected, no claim for refund or credit of the 1919–1922 excises had been filed, and no timely claim for refund or credit could have been filed for over 12 years. There is no statutory provision requiring or permitting the Commissioner of Internal Revenue or a Collector

of Internal Revenue to decline to collect a valid assessment on equitable grounds or to credit against a valid assessment of taxes an overpayment of other taxes which is not legally refundable.[4] Section 3228 in itself indicates that there is no such authority and as pointed out hereinafter (*infra*, pp. 30–38), Sections 608 and 609 of the Revenue Act of 1928 (Appendix, *infra*, pp. 42–43) declare that such an attempt would be void. When Collector Rothensies received from the Commissioner the assessment list with the valid assessment for the additional income taxes for 1935 he was under a statutory duty to collect the assessment.[5]

Suits for the recovery of taxes are a means for testing the legal sufficiency and correctness of the

[4] This is particularly true in the present case because the payment alone of the improperly exacted excise taxes would not have provided a basis for the credit or refund of those taxes even if there had been a timely filed claim for refund. Section 424 (a) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 866, made the right to a refund of the automobile accessories excise tax depend upon a showing by the taxpayer that he had not collected the tax, directly or indirectly, from the purchaser, or, if it was so collected, that the taxpayer had returned the tax to the purchaser. These were matters which the taxpayer must have shown by suitable allegation and have established by appropriate proof. *United States* v. *Jefferson Electric Co.*, *supra*.

Thus in the present case, although the taxpayer paid $912,978.57 of excise taxes on storage batteries from 1919 to June 1922 (R. 6, 28), only $534,205.04 of these taxes were absorbed by it and the remaining amount was passed on to the purchasers of the batteries (R. 33).

[5] Revised Statutes, Sec. 3182; *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373, 381.

administrative action whereby those taxes were determined and collected. The courts have not been vested with general jurisdiction to grant a refund of taxes upon equitable principles where the taxes have been exacted according to law.[6] With respect to the determination, assessment and collection of the income taxes for 1935, there has been strict compliance by the Commissioner and by the Collector with all provisions of law in that regard. It would appear to follow that there could be no recovery by suit of those taxes.

The taxpayer nevertheless maintains that it has a right of recovery of the income taxes for 1935 under the principle of recoupment as developed by this Court in *Bull* v. *United States*, 295 U. S. 247, even in the absence of any statutory provision requiring or permitting the Commissioner or the Collector to reduce the correct assessment of income taxes for the year 1935 by the amount of barred and non-refundable excise taxes for 1919 to 1922. In upholding this contention of the taxpayer, the court below has, we submit, erroneously applied the doctrine of the *Bull* case.

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[6] *Cheatham* v. *United States*, 92 U. S. 85. In *Graham & Foster* v. *Goodcell*, 282 U. S. 409, this Court, in rejecting the contention that Sections 607 and 611 of the Revenue Act of 1928 related solely to administrative action and not to judicial proceedings, said (p. 423):

> It would be anomalous that the right of the taxpayer to obtain a refund from the Department, to which he was under obligation to resort (R. S. 3226, U. S. C. Tit. 26, sec. 156), should be denied, while the right to recover by suit the same amount under exactly the same circumstances should remain unaffected.

2. THE DOCTRINE OF BULL V. UNITED STATES IS INAPPLICABLE BECAUSE THE BARRED EXCISE TAXES FOR 1919–1922 DID NOT ARISE OUT OF THE SAME TRANSACTION AS THE INCOME TAXES FOR 1935 AND BECAUSE RECOVERY OF THE EXCISE TAXES WAS BARRED WHEN THE COMMISSIONER PROCEEDED TO COLLECT THE INCOME TAX

In *Bull* v. *United States*, 295 U. S. 247, the Commissioner had subjected an identical sum of money to both an estate tax and an income tax, by including the sum in a decedent's gross estate and by treating it also as income to the decedent's estate subsequent to his death. The executor contested the correctness of the income tax unsuccessfully before the Board of Tax Appeals. He then paid the income tax and, after filing claim for refund, he brought suit in the Court of Claims. No claim for refund of the estate tax had been filed, and at the time the suit in the Court of Claims was instituted claim for the estate tax was barred by the statute of limitations. This Court held that the income tax was properly and the estate tax improperly imposed. But the Court held that the executor was entitled to have credited against the deficiency of income tax the amount of his overpayment of estate tax with interest under the principle of recoupment and accordingly that the executor was to that extent entitled to judgment. In reaching that conclusion this Court stressed the fact that the Government had given the taxpayer a right of credit or refund of the overpaid estate tax, which, though the taxpayer could not assert it in an

action brought by him at the time suit was begun in the Court of Claims, had accrued and was available to him, since it was actionable and not barred when the Government proceeded against him for the collection of income tax. 295 U. S. at 263. The contrary is true here, for the 1919–1922 excises had long been barred when the Government undertook to collect the 1935 income taxes here involved.

The employment of the doctrine of recoupment in *Bull* v. *United States* as a ground for maintenance of an affirmative action expanded the scope of what was a purely defensive doctrine in the common-law courts of England and of this country[7], and has the effect of granting to a tax-

[7] Recoupment, both at common law and as applied by this Court in the *Bull* case, is a product of judicial action. In this respect it differs from set-off, which is of statutory origin. Recoupment is purely defensive and is confined to matters arising out of the transaction upon which the plaintiff's action is grounded. It goes to the existence of the plaintiff's claim and advances an equitable reason why the plaintiff's claim should be reduced in order that full justice may be done and multiplicity and circuity of action avoided. Since recoupment is purely defensive and arises out of and inheres in the plaintiff's claim and advances reasons why the court should not use its processes to enforce an inequitable claim of the plaintiff, the defense is considered to survive as long as the plaintiff's cause of action exists, although an affirmative action by the defendant upon the subject of the claim may be barred by the statute of limitations. *Wheat* v. *Dotson*, 12 Ark. 699; *Williams* v. *Neely*, 134 Fed. 1 (C. C. A. 8th); *Stow* v. *Yarwood*, 14 Ill. 424; *Pennsylvania R. Co.* v. *Miller*, 124 F. 2d 160 (C. C. A. 5th), certiorari denied, 316 U. S. 676. The Doctrine of Recoupment in Federal Taxation, 28 Va. L. Rev. 577, 579–586 (1941–1942); Counterclaims, 37 Yale L. J.

payer an equitable ground for the recovery of taxes which does not exist under any statute.

The use of the defensive principle of recoupment as an offensive weapon was justified by this Court in the *Bull* case by reason of the fact that the Government in using administrative machinery for the collection of its taxes, and in affording the taxpayer a hearing in the District Courts only after payment, has reversed the usual procedure for the collection of debts.[8] This Court held that in substance the summary administrative proceedings were actions to collect debts alleged to be due the United States and the procedural requirement of payment prior to a suit for refund does not obliterate the substantial right of a taxpayer to rely on a cross demand for credit of the amount which, if the Government had sued him for taxes, he could have recouped against his liability for those taxes.[9]

It is clear, however, that the Court did not mean that recoupment could be used as an

300 (1927–1928); Waterman, Set-Off and Recoupment (1869) 465–478; Restatement, Judgments 217; Tax Refund Claims and the Statute of Limitations, 1 Tax Law Review 45 (1945).

[8] The taxpayer, however, has the right to appeal to the Tax Court prior to assessment or payment of a proposed deficiency in income, estate, and gift tax cases.

[9] If the decision turns upon the substance of the various proceedings, it is clear that the second cause of action in the complaint in the present case in substance seeks a refund of the barred excise taxes for 1919 to 1922. Cf. *Longyear Realty Corp.* v. *Kavanagh* (C. C. A. 6th), decided July 8, 1946 (1946 C. C. H., par. 9317).

offensive weapon by the taxpayer in order to collect a stale claim. Indeed, recovery was predicated on the fact that when the Government proceeded against the taxpayer to collect a second tax on the identical sum of money, refund of the first tax was not barred.[10] 295 U. S. at 263. The converse is true here. When the 1935 tax was assessed and collected, refund of the 1919–1922 taxes had already long been barred.

In *Stone* v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777, the Government was

[10] Moreover, it should be noted that the *Bull* case arose under unique circumstances. The income taxes which the taxpayer sought to recover in the Court of Claims in that case had previously been the subject of a proceeding in the Board of Tax Appeals. The taxpayer had originally contested the proposed assessment of income taxes before the Board, but that proceeding occurred in 1925, before there was any direct judicial review of the Board's decisions (Revenue Act of 1924, c. 234, 43 Stat. 253), and when decisions of the Board were not final. A taxpayer, at that time, could pay the deficiency found by the Board and then relitigate the issue by bringing a suit for refund in the District Court or the Court of Claims, as was done in the *Bull* case itself. Under the Revenue Act of 1926, however, the procedure was changed to provide for direct judicial review of Board decisions in the Circuit Courts of Appeals (c. 27, 44 Stat. 9), and to assure finality of such judgments. See *Dobson* v. *Commissioner*, 320 U. S. 489, 497. The Board of Tax Appeals [Tax Court] itself has no jurisdiction to apply principles of equitable recoupment. *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U. S. 418. Accordingly, had the taxpayer in the *Bull* case brought his proceeding in the Board of Tax Appeals in 1926 or thereafter (instead of 1925 before the Board's decisions were accorded finality), he would not have been able to bring a second proceeding in the Court of Claims. The decision of the Board would have been final, and, under the *Gooch*

allowed to defend on equitable principles where trustees sought to recover a tax which should have been paid by the beneficiary and recovery on the trustees' claim would have inured to the benefit of the beneficiary. The equitable defense was allowed despite the fact that an assessment against the beneficiary was barred, not only when the suit was brought but also when the overpayment was made by the trustees, though not when the assessment against them was made. The two taxes involved in *Stone* v. *White* were on the identical trust income; the issue was simply whether the trustees or the beneficiary owed the tax, and in refusing to allow refund to the trustees the Court simply recognized that a tax on the identical income was owed by the beneficiary. Indeed, the Court's statement that the Government by retaining the tax paid by the trustees was not reviving a stale claim, rested on the ground that there was in reality but a single tax, whether it was nominally imposed on the trustees or the beneficiary. Here, on the other hand, the taxpayer seeks to bring back to life a claim long since expired with respect to

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case, he would not have been entitled to raise any issue of recoupment in the Board.

The fact that the *Bull* case rests upon such unique circumstances that could not arise again, and the fact that Congress has undertaken in 1926 to standardize the litigation pattern as far as possible through the Tax Court (cf. *Dobson* v. *Commissioner*, *supra*) suggest that the doctrine of the *Bull* case which involves the peculiar status of the Board of Tax Appeals during the period 1924–1926, should not be extended.

transactions occurring many years ago. In *Stone* v. *White*, the recoupment claim turned upon the identical event, and no new evidence was required, whereas the so-called recoupment claim here involves facts and transactions that must be established by independent evidence of events occurring in earlier years. If the purpose of a statute of limitations is repose, it is completely frustrated by the decisions below.

Neither *Bull* v. *United States* nor *Stone* v. *White* supports the view that recoupment should be allowed where, as here, the recovery of tax for certain years was barred when the additional tax for a subsequent period was asserted many years later. Such a radical departure from the statutory scheme of limitations with respect to the collection and refund of taxes certainly does not follow from these two decisions.

The doctrine of recoupment as applied by this Court in the *Bull* case retains, as a minimum, the condition essential to its application in suits generally, namely, that the recoupment claim must arise out of some feature of the transaction upon which the claim of the plaintiff is grounded. It may be conceded that the word "transaction" as used in the statement of the doctrine of recoupment in cases involving private parties, and as used in statutory provisions and rules of procedure dealing with the assertion of counterclaims in suits at law or in equity, has been treated as a term of rather broad and flexible meaning. Cf.

Moore v. *New York Cotton Exchange*, 270 U. S. 593, 610; *Lesnik* v. *Public Industrial Corp.*, 144 F. 2d 968, 975 (C. C. A. 2d); *Utilities Service* v. *Walker*, 78 F. 2d 18, 23 (C. C. A. 3d); see also 1 Moore's Federal Practice Under the New Federal Rules 682–684. These cases, however, all dealt with issues and facts that were far removed from the question presented here; none of them involved the revival of stale claims by means of recoupment or any other procedural device.

The court below was of the view that there is little or no help to be had from dictionary or judicial definition or description of the word "transaction" when applied in other situations, to its meaning as used here. Without attempting to settle with exactness what the limits of the word are, the court stated that since the doctrine of recoupment is based on concepts of fairness it saw no reason "for hedging the 'transaction' part of the requirement within close quarters, especially where, as here, there is a logical connection between main claim and recoupment claim." (R. 50, 51.) The logical connection between the main claim in the present case (the claim of the Government for income taxes for 1935) and the recoupment claim (the taxpayer's claim for the barred excise taxes for 1919 to 1922) exists, the court below held (R. 50), in the fact that the barred excise taxes were the same type of tax imposed upon the same nature of merchandise as the excise taxes for the later

periods, the refund of which gave rise to the income tax.

We agree with the view of the court below that recoupment in tax cases presents problems which are not answered by decisions in other fields as to what constitutes the "same transaction". However, the construction which the court below has given to the word "transaction" and the application which it makes of the principle of recoupment offer almost limitless opportunities for circumventing the statute of limitations and the periodical system of federal tax accounting and should not be upheld. As a means for avoiding unusually harsh and inequitable results flowing from a rigid adherence to the statute of limitations the principle of recoupment may serve a desirable end.[11] It is a prin-

[11] Congress has long been aware of the fact that rigid adherence to the statute of limitations frequently produces inequities. House Hearings on Revenue Revision 1927–28, 69–70th Congresses, pp. 148–152, 161–162, 302–303, 307–308, 534–535, 544–545, 547–548, 576–577; House Hearings on Revenue Revision 1934, 73d Cong., 2d Sess., p. 132. By Section 820 of the Revenue Act of 1938 (Appendix, *infra*, pp. 44–49), Congress made provision for an equitable solution of certain classes of hardship cases resulting from application of the statute of limitations. In S. Rep. No. 1567, 75th Cong., 3d Sess., p. 49 (1939–1 Cum. Bull. (Part 2) 779, 815), the Committee on Finance stated:

> The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation, by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running

ciple without express statutory sanction, however, and should not be applied in such a manner as to result in a direct conflict with the statutory purpose.[12] The manner in which the principle has been applied below does, we submit, result in such conflict.

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of the statute. The Federal courts in many somewhat similar tax cases have sought to prevent inequitable results by applying principles variously designated as estoppel, quasi-estoppel, recoupment and set-off. For various reasons, mostly technical, these judicial efforts cannot extend to all problems of this type. Nor can they provide a uniform, systematic solution of these problems. Legislation has long been needed to supplement the equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.

The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment.

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For a discussion of Section 820 see also: Statute of Limitations, 27 Cal. L. Rev. 409–456 (1938–1939); and Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509–532, 719–778 (1939).

[12] It will be noted that the ultimate tax liability may differ substantially when determined according to the relief provisions of Section 820 of the Revenue Act of 1938 [Internal Revenue Code, Section 3801] and when determined under the principle of recoupment. The fact that Congress has

The doctrine of recoupment has been applied primarily in cases where there has been *inconsistent* treatment for tax purposes of the same item or event, and where a correction according to the statutory method of the erroneous treatment of that item or event is prevented by the statute of limitations.[12] In cases where there has been simply an erroneous treatment of an item or event and that erroneous treatment does not have the effect of imposing a double tax upon that item or event, there is no ground for the application of recoupment in favor of the taxpayer. Cf. *Longyear Realty Corp.* v. *Kavanagh*

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enacted relief provisions on principles other than those of recoupment, the fact that it has not invested the Tax Court with jurisdiction to apply the recoupment doctrine, although the bulk of tax litigation goes to that tribunal, and the fact that the entertainment of the recoupment doctrine by the courts is purely a product of judicial action which promotes circumvention of the statute of limitations in a manner which has no statutory basis and without readily definable boundaries for its application, all lead to the conclusion that the courts, if they possess the power to apply the doctrine at all to support the maintenance of suits against the Government, should exercise that power with restraint.

[12] Recoupment applied in favor of taxpayer: *Bull* v. *United States*, *supra*; *Mills* v. *United States*, 35 F. Supp. 738 (N. D. N. Y.); *Dunigan* v. *United States*, 23 F. Supp. 467 (C. Cls.); *Gooch Milling & Elevator Co.* v. *Commissioner*, 133 F. 2d 131 (C. C. A. 8th), reversed on question of jurisdiction, 320 U. S. 418. Recoupment applied in favor of the Government: *Stone* v. *White*, 301 U. S. 532; *Crossett Lumber Co.* v. *United States*, 87 F. 2d 930 (C. C. A. 8th); *West Virginia Pulp & Paper Co.* v. *McElligott*, 40 F. Supp. 765 (S. D. N. Y.); *First Nat. Bank of Birmingham* v. *United States*, 12 F. Supp. 301 (N. D. Ala.).

(C. C. A. 6th), decided July 8, 1946 (1946 C. C. H., par. 9317); *In re Clayton Magazines*, 77 F. 2d 852 (C. C. A. 2d). To express the thought differently, unless the tax asserted by the Government arises from the same item or combination of acts or events upon which the tax sought to be recouped by the taxpayer was laid, the taxes arise out of different transactions and should not be within the scope of the doctrine of recoupment. It should be borne in mind that the whole concept of recoupment as applied in tax cases is simply a judicial technique for circumventing the statute of limitations where its application might be particularly harsh, namely, where there has been an inconsistent treatment of the same item. The use of recoupment in these circumstances has protected the taxpayer against the imposition of a double liability upon the same item and conversely has protected the Government against the taxpayer's escaping tax entirely upon a particular item. But merely because there has been a narrow departure from the statutory scheme of limitations in order to avoid harsh results in these circumstances is no reason for such sweeping disregard of the statutory scheme as was approved herein by the court below.

The decision in *Dixie Margarine Co.* v. *Commissioner*, 115 F. 2d 445 (C. C. A. 6th), relied on by the court below, is at variance with our position. The facts in that case were similar to those of the present case, and the reasoning of the court was much the same as that of the court

below. We believe that the decision in that case, as in the present case, is plainly erroneous. It may be also noted that appeal in that case was from the Board of Tax Appeals, and the court was therefore without jurisdiction of the recoupment question. *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U. S. 418.

In the present case the excise taxes over the seven year period from 1919 to 1926 were all upon the manufacture and sale of electric storage batteries, and the statutory provisions under which the taxes were imposed were substantially the same during that time. But these circumstances concededly did not permit the joining of a claim for the excise taxes for the periods from 1919 to June 1922 in the suit which the taxpayer brought in 1928 against the then Collector of Internal Revenue for refund of the excise taxes for the periods from June 1922 to 1926, because, even in 1928, suit for the earlier years had already been barred for almost two years through failure to file a timely claim for refund for those years. With all the greater reason these facts would not support the assertion of a claim for the barred excise taxes in the suit for a refund of the 1935 income taxes, for the income taxes were imposed upon the *refund* of the 1922–1926 excise taxes and hence there was even less relationship between the income taxes and the barred 1919–1922 excise taxes than between the barred excise taxes and the 1922–1926 excise taxes.

The only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. It may be further pointed out that there was no inequity in the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, for the taxpayer had deducted those excise taxes in its income tax returns for the years 1922 to 1926 and thereby had secured a tax benefit equal to the 1935 income taxes.

If the recoupment principle is to be applied to distinct transactions merely because they grow out of earlier transactions which were similar but not related, the scope of the principle is of wider compass than has been generally understood. We believe the principle should not be so extended. We accordingly submit that the holding of the court below that the present case is within the scope of the principle should be reversed.

II

RECOUPMENT OF THE BARRED EXCISE TAXES IS, IN ANY EVENT, PRECLUDED BY SECTIONS 608–610 OF THE REVENUE ACT OF 1928

The Collector contended in the District Court and in the court below that in any event recoupment in the present case was barred by the provisions of Section 608 (a) and 609 (b) of the

Revenue Act of 1928 (Appendix, *infra*, pp. 42, 43). This contention was rejected by the court below.

Section 608 (a) provides that a refund of any portion of an internal revenue tax, made after the enactment of that Act, shall be considered erroneous if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed. Section 609 (b) provides that a credit, whether made before or after the enactment of the Act, of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under Section 608.

Under Revised Statutes, Section 3228, as amended (Appendix, *infra*, p. 50), claims for refund of the excise taxes for the periods 1919 to 1922 could not have been filed later than 1926. But no claim was ever filed and consequently under Revised Statutes, Section 3226 (Appendix, *infra*, pp. 49–50), no suit could be maintained for such taxes. Hence, under Section 608 (a) a refund of those taxes after the statute of limitations had run in 1926 would have constituted an erroneous refund, which the United States could have recovered under Section 610 (Appendix, *infra*, pp. 43–44), and under Section 609 (b) a credit of the overpayment against the income taxes for 1935 would have been void.

In two cases the Court of Claims, assuming that a taxpayer would otherwise be entitled to a recovery of taxes upon the basis of recoupment,

has held that this right was barred by Sections 608 (a) and 609 (b). *Hall* v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664; *Lynchburg Coal and Coke Co.* v. *United States*, 47 F. Supp. 916. In the *Hall* case the taxpayer, who owned an interest in a leasehold estate, had not been allowed depreciation and amortization in its tax returns for years prior to 1929. Upon the sale of the leasehold estate in 1932, the Commissioner reduced the basis for computing profit or loss by the amount of the actual depreciation for the years prior to 1929, and the taxpayer in the suit in the Court of Claims sought to recoup against the income taxes for 1932 the barred overpayments for years prior to 1929, which would have resulted from an allowance of depreciation in those years. In the *Lynchburg Coal and Coke Co.* case, the Commissioner had disallowed depletion for the years 1913 to 1917, which action was shown by a later decision of this Court to have been erroneous. In determining taxpayer's deduction for depletion in later years the Commissioner treated the erroneously disallowed depletion for earlier years as having been allowable, and the taxpayer sought to recoup the barred overpayment for the earlier years. In those two cases, there was a much sounder foundation for the argument that the barred overpayment and the taxes sued for arose out of the same transaction than in the present case.

In reaching the conclusion that recoupment was barred by Sections 608 (a) and 609 (b) the Court of Claims adopted the reasoning of this Court in *McEachern* v. *Rose*, 302 U. S. 56, where the Government had attempted to rely on recoupment as a defense to a taxpayer's suit for refund. In the *McEachern* case the question was whether overpayments of income taxes for the years 1929, 1930 and 1931 were so related to a tax on income which should have been but was not assessed against the taxpayer for the year 1928 as to preclude recovery of the overpayments although collection of the 1928 tax was barred by the statute of limitations. This Court assumed that in the circumstances of that case equitable principles would prevent recovery in the absence of any statutory provisions requiring a different result. However, this Court held that Section 607 and 609 (a) of the Revenue Act of 1928 (Appendix, *infra*, pp. 42, 43) precluded the Government from taking any benefit from the taxpayer's overpayment by crediting it against the unpaid tax whose collection had been barred by limitation.

Section 607 declares that any payment of a tax after expiration of the period of limitation shall be considered an overpayment and directs that it be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim, and Section 609 (a) provides that any credit against a liability

in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under Section 607. Sections 607 and 609 (a) thus parallel Sections 608 and 609 (b), the first two provisions dealing with the effect of the expiration of the period of limitation against the United States, and the second two provisions dealing with the effect of the expiration of the period of limitation against the taxpayer.

The court below was of the view that the limitation in these sections, upon the use of the doctrine of recoupment, applies only against the Government and not against the taxpayer. It reached this conclusion because of the difficulty in reconciling the decision of *McEachern* v. *Rose, supra,* with that of *Bull* v. *United States, supra,* and because of the supposed public policy involved in protecting taxpayers who pay taxes first and litigate their correctness later.

We agree with the view of the court below that there is some difficulty in reconciling the *McEachern* and the *Bull* and *Stone* v. *White* cases, though it is to be noted that no question as to the effect of Sections 607–609 of the Revenue Act of 1928 was raised or considered in the *Bull* case, and in *Stone* v. *White* as was pointed out in the *McEachern* case itself the statute did not apply because technically at least there were two taxpayers and an overpayment of one could not be

credited against the tax due from the other.[14] But we submit there is no basis for the conclusion that the sections quoted above operate as a limitation only against the Government.

Sections 607–610 of the Revenue Act of 1928 were enacted because Section 1106 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, failed to resolve many doubtful questions as to the legal effect of the expiration of the period of limitations prescribed for the assessment or collection of a tax or for the making of a refund or credit, or the bringing of a suit for refund. H. Rep. No. 2, 70th Cong., 1st Sess., pp. 33–34 (1939–1 Cum. Bull. (Part 2) 384, 406). Section 1106 (a) of the Revenue Act of 1926 had provided that the bar of the statute of limitations against the United States and against the taxpayer in respect to any internal revenue tax should operate to bar the remedy and also extinguish the liability, with the condition that no credit or refund in respect of such tax should be allowed unless the taxpayer

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[14] The lower federal courts have uniformly followed *McEachern* v. *Rose* where the Government or the Collector has sought to defeat a recovery of tax by recoupment of a barred deficiency. *American Light & Traction Co.* v. *Harrison*, 142 F. 2d 639 (C. C. A. 7th); *Lyeth* v. *Hoey*, 112 F. 2d 4 (C. C. A. 2d); *Rotenberg* v. *Sheehan*, 48 F. Supp. 584 (E. D. Mo.); *Crawford* v. *Heiner*, 23 F. Supp. 240 (W. D. Pa.). However, the courts have expressed difficulty in reconciling *McEachern* v. *Rose* with *Bull* v. *United States*, *supra*, and *Stone* v. *White*, *supra*; and in the *American Light & Traction Co.* and *Lyeth* cases, *supra*, there were vigorous dissents from the majority rulings.

had overpaid the tax and that no collection in respect of such tax should be made unless the taxpayer had underpaid the tax. The provisions contained in Section 1106 (a) were incorporated in the Revenue Act of 1926 because of the opinion of the Court of Claims in the case of *Toxaway Mills* v. *United States*, 61 C. Cls. 363; H. Rep. No. 356, 69th Cong., 1st Sess., p. 55 (1939–1 Cum. Bull. (Part 2) 361, 380). In that case the Court of Claims had expressed the view that although the statute of limitations was jurisdictional so far as it concerns suits against the United States in the Court of Claims, the statute, in so far as it pertained to the right of the Government to proceed against the taxpayer for additional taxes barred only the remedy and did not extinguish the right, and accordingly that even in a suit by a taxpayer to recover taxes collected after the expiration of the statute of limitations the burden was upon the taxpayer to show that the Government, *ex aequo et bono*, is bound to refund the amount which the taxpayer paid.

There is nothing either in the wording or in the legislative history of Sections 607–610 to indicate that those sections were intended to limit the right of the Government to urge the doctrine of recoupment as a defense to a recovery of taxes and at the same time to preserve to taxpayers a right to employ that doctrine to recover taxes paid by them. Justification for the conclusion that Sections 607–610 are limitations against the

Government only and not against taxpayers is not found, we submit, in a supposed public policy to protect taxpayers who pay taxes first and litigate their correctness later. Indeed, such legislative history as there is indicates a Congressional purpose to place the Government and the taxpayer upon an equal basis.

Under the reasoning in the *Bull* case, the taxpayer was enabled to advance the doctrine of recoupment because he had *failed* to report and pay the income taxes due from him at the time he should have reported and paid them, thus compelling the Commissioner to assert a deficiency against him, which this Court construed as a proceeding to collect a tax to which the defense of recoupment could be made. In that case the taxpayer's failure to report the income was perhaps warranted in view of the fact that the Government had already collected an estate tax on the identical income under what this Court held to be inconsistent action. In the present case the taxpayer likewise failed to make an initial report of the 1935 income in question and forced the Commissioner to assert a deficiency. But if the taxpayer had reported that income in its original return for 1935 and had paid the tax at that time, as it should have done, it would have had no ground for contending to be within the reasoning of the *Bull* case. The theory of the court below puts a premium upon a tax-

payer's failure to report income upon which a tax is properly due, thus compelling the Commissioner to proceed against him. There is, we submit, no public policy which supports this theory.

The court below also held (R. 53) that Sections 608 and 609 of the Revenue Act of 1928 should be interpreted as applying only to cases which arose after its passage. That this was not the intention of Congress is plainly shown by the language of those sections. Section 608 provides that under the circumstances therein stated a refund of any portion of an internal revenue tax "made after the enactment of this Act" shall be considered erroneous. And Section 609 (e) provides that the provisions of that section shall apply to any credit made "before or after the enactment of this Act."

We submit that if this Court adheres to the holding of *McEachern* v. *Rose, supra,* that Sections 607 and 609 (a) of the Revenue Act of 1928 preclude the right of the Government to defeat a recovery of an overpayment of taxes by showing that the taxpayer has underpaid other taxes growing out of the same transaction, assessment of which is barred, then the conclusion is compelled that Sections 608 and 609 (b) preclude a taxpayer from recovering a correct tax by showing that it has overpaid other taxes, the recovery of which is barred by the statute of limitations.

III

IN THIS SUIT AGAINST COLLECTOR ROTHENSIES FOR REFUND OF TAXES PAID TO HIM, THE TAXPAYER MAY NOT RECOUP EXCISE TAXES PAID TO THIS COLLECTOR'S PREDECESSORS IN OFFICE

The taxpayer purports in this case to seek a recovery of only the income taxes paid to Collector Rothensies, against whom the suit has been brought. The taxes collected by this Collector were properly determined and assessed, and no suggestion has been made that the Collector failed to comply with all statutory provisions respecting the collecting of those taxes. The collection of the income taxes in suit was therefore valid and legal. The excise taxes which the taxpayer seeks to recoup were paid to this Collector's predecessors in office.

In *United States* v. *Kales*, 314 U. S. 186, and *United States* v. *Nunnally Investment Co.*, 316 U. S. 258, the Government contended that a suit against a Collector of Internal Revenue is no longer "personal" but merely an expedient for bringing the Government into court. However, this Court rejected the Government's contention.[15]

[15] Those cases involved the question of *res judicata*. With respect to that question only, the result in those decisions has been changed by Section 503 of the Revenue Act of 1942, which added a new provision to Section 3772 of the Internal Revenue Code to the effect that in applying the doctrine of *res judicata* in suits instituted after June 15, 1942, a suit against a Collector shall be treated as if the United States had been a party.

In the *Kales* case, this Court said (pp. 199–200):

> It was payment to the collector which gave rise to the suit against him and limited the amount of the recovery. The judgment against the Collector is a personal judgment, to which the United States is a stranger except as it has obligated itself to pay it. * * *
>
> * * * * * *
>
> By no possibility could the respondent in the suit brought against Collector Woodworth in 1925 recover taxes paid to Collector Grogan in 1920, which she demands here. * * *

The doctrine in those cases plainly forbids a refund from a Collector, whether through recoupment, set-off, or other procedural device, on account of taxes paid to a different Collector.

In the present case Collector Rothensies was a stranger to the payment of the excise taxes collected by his predecessors in office. His predecessors in office, as well as the United States, are strangers to the judgment in the present case. Even under the doctrine of set-off one party to litigation may not defend against the claim of the other party to the litigation by setting up a claim which he may have against a third party who is a stranger to the litigation. Cf. *Dakin* v. *Bayly*, 290 U. S. 143; *Wilson* v. *Codman's Ex'r*, 3 Cranch 193. That is true with even greater force under the doctrine of recoupment where the

cross-claim must arise out of some feature of the same transaction.

The effect of the decision below is to allow a personal judgment against Collector Rothensies because of payments made to his predecessors in office, which, we submit, is contrary to the principle of the *Kales* and *Nunnally* cases.

CONCLUSION

The judgment of the court below is erroneous and should be reversed.

Respectfully submitted,

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SEPTEMBER 1946.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 607. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.

SEC. 608. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST TAXPAYER.[16]

A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or

(b) in the case of a claim filed within the proper time and disallowed by the Commissioner after the enactment of this Act, if the refund was made after the expiration of the period of limitation for filing suit, unless—

[16] The last sentence of Section 608 (b) (2) of the Revenue Act of 1928 was added by Section 503 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

(1) within such period suit was begun by the taxpayer, or

(2) within such period, the taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named cases then pending before the United States Board of Tax Appeals or the courts. If such agreement has been entered into, the running of such statute of limitations shall be suspended in accordance with the terms of the agreement.

SEC. 609 ERRONEOUS CREDITS.

(a) *Credit against barred deficiency.*—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

(b) *Credit of barred overpayment.*—A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608.

(c) *Application of section.*—The provisions of this section shall apply to any credit made before or after the enactment of this Act.

SEC. 610. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

(a) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 608, after the enactment of this Act, may be recovered by suit brought in the name of the United States, but only if such suit is begun within two years after the making of such refund.

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 820. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term "determination under the income tax laws" means—

(A) A closing agreement made under section 606 of the Revenue Act of 1928, as amended;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Com-

missioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which has become final, or claim for refund finally disposed of, prior to ninety days after the date of the enactment of this Act.

(2) *Taxpayer.*—Nothwithstanding the provisions of section 901, the term "taxpayer" means any person subject to a tax under the applicable Revenue Act.

(3) *Related Taxpayer.*—The term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination specified in subsection (b) (1), (2), (3), or (4) is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance therein referred to was made, in one of the following relationships: (A) husband and wife; (B) grantor and fiduciary; (C) grantor and beneficiary; (D) fiduciary and beneficiary, legatee, or heir; (E) decedent and decedent's estate; or (F) partner.

(b) *Circumstances of Adjustment.*—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(4) Allows or disallows any of the additional deductions allowable in computing the net income of estates or trusts, or requires or denies any of the inclusions in the computation of net income of beneficiaries, heirs, or legatees, specified in section 162 (b) and (c) of this Act, and corresponding sections of prior revenue Acts, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer; or

(5) Determines the basis of property for depletion, exhaustion, wear and tear, or obsolescence, or for gain or loss on a sale or exchange, and in respect of any transaction upon which such basis depends there was an erroneous inclusion in or omission from the gross income of, or an erroneous recognition or nonrecognition of gain or loss to, the taxpayer or any person who acquired title to such property in such transaction and from whom mediately or immediately the taxpayer derived title subsequent to such transaction—

and, on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before, on, or after the date of enactment of this Act) of any provision of the internal-revenue laws other than this section and other than section 3229 of the Revised Statutes, as amended (relating to compromises),

then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c)) or by the taxpayer with respect to whom the determination is made (in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be. In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency, the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Board of Tax Appeals for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

(c) *Method of Adjustment.*—The adjustment authorized in subsection (b) shall be made by assessing and collecting, or refunding or crediting, the amount thereof, to be ascertained as provided in subsection (d), in the same manner as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year with respect to

which the error was made, and as if on the date of the determination specified in subsection (b) one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year.

(d) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this section there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be (1) the tax shown by the taxpayer, with respect to whom the error was made, upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (2) if no amount was shown as the tax by such taxpaper upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. There shall then be ascertained the increase or decrease in the tax previously determined which results solely from the correct exclusion, inclusion, allowance, disallowance, recognition, or nonrecognition, of the item, inclusion, deduction, credit, gain, or loss, which was the subject of the error. The amount so ascertained (together with any amounts wrongfully collected, as additions to the tax or interest, as a result of such error) shall be

the amount of the adjustment under this section.

(e) *Adjustment Unaffected by Other Items, Etc.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this section, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss other than the one which was the subject of the error.

(f) *No Adjustment for Years Prior to 1932.*—No adjustment shall be made under this section in respect of any taxable year beginning prior to January 1, 1932.

Revised Statutes:

SEC. 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of [the] Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought without first having

a decision of the Commissioner at any time within the period limited in the next section.

SEC. 3228 [as amended by the Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 1112; Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 619 (c); Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1106 (a)]. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected must, except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum. The amount of the refund (in the case of taxes other than income, war-profits, excess-profits, estate, and gift taxes) shall not exceed the portion of the tax, penalty, or sum paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

* * * * * * *

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IN THE

Supreme Court of the United States

October Term, 1945 No. 892 18

WALTER J. ROTHENSIES, Individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania,

Petitioner

v.

THE ELECTRIC STORAGE BATTERY COMPANY, a Corporation

Brief for Respondent in Opposition to Petition for a Writ of Certiorari

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INDEX

		Page
I.	Opinions of Courts Below	1
II.	Jurisdiction	1
III.	Question Presented	2
IV.	Statement of the Case	2
V.	Argument	4
	Summary	4
	Point 1	4
	Point 2	5
	Point 3	6
	Point 4	8
VI.	Conclusion	9

CITATIONS

Cases:

Bull v. United States, 295 U. S. 247	5, 6, 7, 9
Claridge Apartments v. Commissioner, 323 U. S. 141	8
Commissioner v. Gooch M. & E. Co., 320 U. S. 418	7
Hassett v. Welch, 303 U. S. 303	8
McEachern v. Rose, 302 U. S. 56	6, 7
Moore v. New York Cotton Exchange, 270 U. S. 593	5
Stow v. Yarwood, 14 Ill. 424	5
U. S. v. St. Louis, etc., Ry. Co., 270 U. S. 1	8
Valleytown Tp. v. Women's Catholic Order, 115 F.2d 459	8

Statutes:

Revenue Act of 1928—	
Section 607	6
Section 608(a)	4, 6
Section 609(a)	6
Section 609(b)	4, 6

Text:

50 American Jurisprudence 500	8

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1945 No. 892

WALTER J. ROTHENSIES, Individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania, *Petitioner*

v.

THE ELECTRIC STORAGE BATTERY COMPANY, a corporation.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

I. OPINIONS OF COURTS BELOW.

Electric Storage Battery Company v. Rothensies (1944) 57 F. Supp. 731 (R. 5a-17a).

Electric Storage Battery Company v. Rothensies (CCA3-1945) 152 F. 2nd 521 (R. 2-9).

II. JURISDICTION.

1. The jurisdiction of this Court is invoked under the Judicial Code, Section 240 (a), as amended by the Act of February 13, 1925, ch. 229, 43 Stat. 938 (28 USCA § 347).

2. The judgment of the Circuit Court of Appeals was entered on November 27, 1945 (R. 9).

III. QUESTION PRESENTED.

Where the Government illegally collected money prior to 1928 from a corporation under the guise of excise taxes, part of which it later refunded and made a deficiency income and excess profits tax assessment on the refund, is not the corporation entitled to recoup the moneys not refunded against the deficiency assessment?

IV. STATEMENT OF THE CASE.

During the seven years between March 1, 1919, and February 28, 1926, the Government illegally exacted 84 monthly payments from the respondent as excise taxes on the respondent's sales of electric storage batteries upon the erroneous theory that the batteries were parts of automobiles. All of the assessments were upon the same types of batteries. In 1935, as a result of litigation instituted by the respondent, the Government refunded the last 45 payments, these being the payments made between 1922 and 1926 (R. 2). The Government treated this refund as income in the year 1935 and assessed a deficiency income and excess profits tax on the refund which, together with interest, amounted to $229,805.34 (R. 6a). The respondent sought to recoup against this assessment the first 39 monthly payments which had been made between 1919 and 1922 and which the respondent had not asked to recover in the prior litigation because of the bar of the statute of limitations (R. 2). The total amount of the payments made between 1919 and 1922 and which the respondent had absorbed itself is $534,205.04 (R. 6a). After the Government rejected the respondent's argument that it had a defense by way of recoupment to the entire deficiency assessment, the respondent paid this additional tax to the petitioner under protest (R. 2). After a claim for refund was denied, this suit was instituted to recover the payment and to obtain an adjudication of the validity of the recoupment defense (R. 2).

The money the respondent paid to the petitioner and which it seeks to recover from him in this litigation was paid by him to the Treasurer of the United States, as required by law: 26 U.S.C. § 3950. The moneys the respondent seeks to recoup were also paid by the Collector to the Treasurer of the United States, as required by law. (R. 20a-21a).

The District Court found that even after the Government is given credit for the respondent's income tax savings arising out of credits taken for the payment of all the excise taxes, the Government still has in its hands more than the amount of the 1935 deficiency tax assessment. (R. 17a). The following calculation shows the situation exactly:

Respondent's 1919-1922 net payments of excise taxes		$534,205.04
Respondent's income tax savings on above	$178,691.52	
Respondent's income tax savings on 1922-1926 payments	139,668.83	
		318,360.35
Net overpayment withheld by Government		$215,844.69
Additional 1935 income and excess profits taxes demanded and collected by Government		198,023.87
Overpayment by respondent after recoupment		$17,820.82

Although the total deficiency assessment paid in 1938 and based on the 1935 refund was $229,805.34, this was made up of additional tax of $198,023.87 plus interest thereon to the date of payment in 1938 of $31,781.47.

We disagree with the statement on page 6 of the petition that "The District Court held that the deficiency in 1935 income and excess profits tax was properly assessed

and collected, . . ." The Court held that the tax was properly assessed but that there was no right to collect any of the assessment because respondent's right of recoupment was a defense to the entire deficiency claim, (R. 13a), and the Circuit Court of Appeals agreed. (R. 8).

V. ARGUMENT.

SUMMARY.

Point 1. The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

Point 2. There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

Point 3. Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (a) they do not purport to affect the jurisdiction of Federal Courts and (b) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

Point 4. The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to collect from the petitioner moneys paid to him which he had no right to demand or collect.

Point 1.

The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

The petitioner's first reason for his petition is that the decision is "an unwarranted extension of the principle of the *Bull* case."

In **Bull v. United States (1935) 295 U. S. 247,** this Court held that the common law doctrine of recoupment was applicable to the facts there presented. The Court did not purport to set forth the limits of its application other than saying, "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." (Page 262). The Court did not there define the word "transaction" but in a closely analogous situation the Court said in **Moore v. New York Cotton Exchange (1926) 270 U. S. 593, 610:** "'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." In the leading case of **Stow v. Yarwood (1853) 14 Ill. 424, 426-27,** the Court said that recoupment "adjusts by one action adverse claims growing out of the same subject matter. . . . It is not necessary that the opposing claims should be of the same character . . . It is sufficient that the counterclaims arise out of the same subject matter, and that they are susceptible of adjustment in one action."

The recoupment doctrine came into the law to promote justice and should be liberally applied to accomplish that end wherever that can be done without undue procedural or administrative difficulty and no rule of public policy prevents it. Its convenient application to this case to enable the respondent to derive a benefit from the more than half million dollars of its money, originally obtained by duress (R. 19a), which the Government holds is in no sense an "unwarranted extension" of the doctrine of recoupment, as the careful analysis and documentation in Judge Goodrich's opinion shows: (R. 3-5).

Point 2

There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

Point 3

Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (a) they do not purport to affect the jurisdiction of Federal Courts and (b) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

In *Bull v. United States*, supra, this Court held that a taxpayer could recoup against the Government's claim for valid taxes a tax which he had erroneously paid but could not recover back because of the statute of limitations. In so holding, this Court "permitted the taxpayer to accomplish indirectly what it could not do directly," which is the complaint made in the present case on page 10 of the petition. This indirect accomplishment is the inevitable result of the application of the recoupment rule in any case. In the *Bull* case the taxpayer was permitted to assert a right of recoupment which was created prior to the enactment of the Revenue Act of 1928 in litigation which was not started until *after* the effective date. In **McEachern v. Rose (1937) 302 U. S. 56** this Court held that after the enactment of Sections 607 and 609(a) of the Revenue Act of 1928 (which are not the sections relied on by petitioner), *the Government* could not credit against a taxpayer's overpayment an unpaid tax whose collection was barred by limitation (and which in fact did not become due until after the enactment of the 1928 Act). In the *McEachern* case the defense did not set up a plea of recoupment but alleged that in view of the fact that the taxpayer was suing in *indebitatus assumpsit*, "it would be unconscionable for the plaintiff to be allowed any recovery." The Circuit Court of Appeals sustained the Government's defense upon the theory that in view of the historical development of indebitatus assumpsit, the action "may not be used to obtain money which the plaintiff ought not, in good conscience, to have back:" 86 F. 2nd 231, 233. We submit that when this

Court decided that case, it did no more than hold that in a suit by a taxpayer to recover an overpayment *which the statute entitles him to receive*, the Government cannot raise the equitable defense that keeping the overpayment does not result in unjust enrichment. This is certainly the view which was argued strongly to the Court in the brief of the *amicus curiae*, particularly on pages 7 and 8 thereof. On the other hand, where the taxpayer is resisting the collection of a tax under the pleaded defense of recoupment, *Bull v. United States* is the controlling authority and it was cited with apparent approval by this Court six years after the decision in the *McEachern* case: **Commissioner v. Gooch M. & E. Co. (1943) 320 U. S. 418, 421.**

The petitioner has not cited a single case in which a taxpayer who has clearly proved the Government had his money has not been permitted to recoup it where the elements of recoupment were present. The two decisions of the Court of Claims cited on page 11 of the petition are not at all in direct conflict with the decision in this case. Those are both cases in which the taxpayer did not prove that he had ever made a true overpayment out of which any right of recoupment could arise and, in addition, different transactions were probably involved, so no rule of recoupment could be applied. There is language, however, in the opinions which shows that the Court of Claims failed to see the distinction between cases falling within the rule of *McEachern v. Rose* and those falling within the rule of *Bull v. United States*. There is definitely no conflict presented to this Court in the present petition for certiorari.

A second reason why the Revenue Act of 1928 has no application to the present litigation is that when the Government forced the respondent to make payments to it in 1919, 1920, 1921 and 1922, at the moment each illegal exaction was paid, a legal right to get it back arose. That right continues to exist and may be asserted defensively in a plea of recoupment. That it is a valuable substantive

right is evident: it constitutes a complete defense to a deficiency assessment claim of $229,000. Surely a 1928 statute containing directions to the Commissioner concerning "credits" and "refunds" did not destroy the respondent's existing right to plead recoupment. At the most, it did no more than close the Commissioner's ear to such an argument, and require the respondent to resort to a Court possessing general equity jurisdiction, to assert his right of recoupment. A statute will not be construed as destroying an existing right unless the legislative intent to do so is expressed in clear and unmistakable language, and even then the statute faces constitutional obstacles: **50 American Jurisprudence 500.** "Every reasonable doubt is resolved against a retroactive operation of a statute": **Valleytown Tp. v. Women's Catholic Order (CCA 4, 1940), 115 F. 2d 459, 462; U. S. v. St. Louis etc. Ry. Co. (1926), 270 U. S. 1; Hassett v. Welch (1938), 303 U. S. 303; Claridge Apartments Co. v. Commissioner (1944) 323 U. S. 141.**

Point 4

The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to collect from the petitioner moneys paid to him which he had no right to demand or collect.

The respondent sued the petitioner to recover from *him* the sum of $229,805.34 which had been paid to *him* on December 3rd, 1938. The theory is that *he* illegally collected this money as Collector of Internal Revenue because no money was owing to the Government by the respondent. The judgment of the Court below is that the respondent is entitled to recover back from the petitioner the money paid to *him*. The judgment does not require him to pay back moneys paid to any other Collector. The petitioner's argument on page 12 of his petition ignores the facts in the

case and the fact that in tax litigation the position of the parties to the suit is generally the reverse of that in ordinary litigation. The respondent could have asserted the defense of recoupment if the Government had instituted suit to collect the 1935 deficiency. *Bull v. United States* is authority for the proposition that the respondent did not worsen its position by paying the 1935 deficiency assessment and suing the Collector to whom that payment was made to get the money back again.

VI. CONCLUSION.

The decision of the Circuit Court of Appeals in this case is correct; there is no conflict of circuits; the case does not involve an important question of Federal Law which has not been, but should be, settled by this Court, or the decision of a Federal question in a way probably in conflict with applicable decisions of this Court. On the contrary, the decision is in accord with the settled common law relating to recoupment and with the decision of this Court in *Bull v. United States*, and the petition should be denied.

Respectfully submitted,

LAURENCE H. ELDREDGE,

CHARLES C. NORRIS, JR.,

Attorneys for Respondent.

IN THE

Supreme Court of the United States

October Term, 1946 No. 48

WALTER J. ROTHENSIES, Individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania,

Petitioner

v.

THE ELECTRIC STORAGE BATTERY COMPANY, a Corporation

BRIEF FOR RESPONDENT

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INDEX

	Page
I. Opinion of Courts Below	1
II. Jurisdiction	1
III. Questions Presented	2
IV. Statement of the Case	3
V. Argument	5
Summary	5
Point 1. The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts	5
1. The Facts and the Doctrine of Equitable Recoupment	6
2. The Scope of the Doctrine of Equitable Recoupment	13
3. Comments Upon the Petitioner's Argument Concerning Recoupment	16
Point 2. Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (1) they do not purport to affect the jurisdiction of Federal Courts and (2) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date	22
Point 3. There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood	22
1. The Sections do not Change the Jurisdiction of Federal Courts	22
2. The Sections are not Retroactive and do not destroy Substantive Rights	30

Page

Point 4. The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to recover from the petitioner moneys paid to him which he had no right to collect 32

Point 5. The Moneys Paid to the Respondent in 1935 as a Refund of Moneys Illegally Exacted from the Respondent in the Years 1922 to 1926 Were Improperly Assessed as Income in 1935 and Should be Treated as Income in the Earlier Years 34

Conclusion 44

Appendix:

McEachern v. Rose (1937), 302 U. S. 56 ..... 1a

Analysis of Pleadings, Issues in the Case, Points Argued in the Supreme Court, and Decision of the Supreme Court 1a

CITATIONS

Cases:

American Light & Traction Co. v. Harrison (CCA 7, 1944), 142 F.(2d) 639 ..... 20, 28, 29

Ben Bimberg Co. v. Helvering (CCA 2, 1940), 126 F.(2d) 412 41

Bergan v. Commissioner (CCA 2, 1935), 80 F. (2d) 89 37

Bohemian Breweries v. United States (Ct. Cl. 1939), 27 F. Supp. 588 40

Bull v. United States (1935), 295 U. S. 247 7, 14, 27, 33

Claridge Apartments Co. v. Commissioner (1944), 323 U. S. 141 30

Page

Commissioner v. Gooch Milling and Elevator Co. (1943), 320 U. S. 418 ..... 10, 11, 29

Cooperstown Corporation v. Commissioner (CCA 3, 1944), 144 F.(2d) 693 37

Crawford v. Heiner (D. C. Pa. 1938), 23 F. Supp. 240 28

Crossett Lumber Co. v. United States (CCA 8, 1937), 87 F.(2d) 930 ..... 10, 14

Dixie Margarine Co. v. Commissioner (CCA 6, 1940), 115 F.(2d) 445 ..... 11, 29

Dixie Pine Products Co. v. Commissioner (1944), 320 U. S. 516 36

Dunigan v. United States (Ct. of Cl. 1938), 23 F. Supp. 467 ..... 13, 29

Freihofer Bakng Co. v. Commssoner (CCA 3, 1945), 151 F.(2d) 383 41

Gooch Milling & Elevator Co. v. Commissioner (CCA 8, 1943), 133 F.(2d) 131 ..... 10, 29

Grand Central Public Market v. U. S. (D. C. Cal. 1938), 22 F. Supp. 119 28

Hassett v. Welch (1938), 303 U. S. 303 30

Hoboken Land & Improvement Co. v. Commissioner (1942), 46 B.T.A. 495, (CCA 3, 1943), 138 F.(2d) 104 41

Houbigant, Inc., v. Commissioner (1934), 31 B.T.A. 954 39

Inland Products Co. v. Blair (CCA 4, 1929), 31 F.(2d) 867 37

Knowlton v. Moore (1900), 178 U.S. 41 23

Leach v. Commissioner (CCA 1, 1931), 50 F.(2d) 371 37

Lyeth v. Hoey (CCA 2, 1940), 112 F.(2d) 4 ..... 24, 28

Lynchburg Coal & Coke Co. v. U. S. (1942), 47 F. Supp. 916 20

MacPherson v. Buick Motor Co. (1916), 217 N. Y. 382 20

Page

McEachern v. Rose (1937), 302 U. S. 56 ..... 18, 26

Mills v. United States (D.C.N.Y., 1940), 35 F. Supp. 738 13, 14

Moore v. New York Cotton Exchange (1926), 270 U.S. 593 13

Nash v. Commissioner (1936), 34 B.T.A. 675 40

Rotenberg v. Sheehan (D.C.Mo. 1943), 48 F. Supp. 584 28

Stone v. White (1937), 301 U.S. 532 9

Stow v. Yarwood (1853), 14 Ill. 424 14

Towne v. Eisner (1918), 245 U.S. 418 13

Union Trust Co. v. Commissioner (CCA 7, 1940), 111 F.(2d) 60 41

United States v. American Ry. Express Co. (1924), 265 U.S. 425 35

United States v. St. Louis, etc., Ry. Co. (1926), 270 U.S. 1 30

Valleytown Tp. v. Women's Catholic Order (CCA 4, 1940), 115 F.(2d) .459 30

Victoria Paper Mills Co. v. Commissioner (1935), 32 B.T.A. 666 40

West Va. Pulp & Paper Co. v. McElligott (D.C. N.Y. 1941), 40 F. Supp. 65 31

Statutes Cited:

Revenue Act of 1918
Section 900 15

Revenue Act of 1921
Section 900 15

Revenue Act of 1928
Section 607 ..... 25, 26, 28, 31
Section 608 ..... 22, 28, 30
Section 608(a) 27, 30

	Page
Section 609	28, 31
Section 609(a)	25, 26
Section 609(b)	27, 30
Section 609(c)	30
Section 617	23
Revenue Act of 1938	
Section 820	19
Internal Revenue Code of 1939	
Section 3770(2)	31
Section 3774(a)	23
Section 3775	31
Section 3775(b)	23
29 U.S.C. §§104, 105, 107	23
26 U.S.C. §3950	33
Miscellaneous:	
50 American Jurisprudence 467, 468	23
50 American Jurisprudence 500	30
Doctrine of Recoupment in Federal Taxation, The, by McConnell (1942), 28 Va. L. Rev. 577	14
Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin No. 3, p. 115 (1920)	37
Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin XI-2 (1932)	38
Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin 1937-1, pp. 93-94, Mim. 4564	42
Waterman on Setoff, Recoupment and Counterclaims (2d ed. 1872), p. 480	14

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946 No. 48

WALTER J. ROTHENSIES, Individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania, *Petitioner*

v.

THE ELECTRIC STORAGE BATTERY COMPANY, a corporation.

BRIEF FOR [illegible]SPONDENT

I. OPINIONS OF COURTS BELOW

Electric Storage Battery Company v. Rothensies (1944) 57 F. Supp. 731 (R. 37-45).

Electric Storage Battery Company v. Rothensies (CCA3-1945) 152 F. 2nd 521 (R. 48-55).

II. JURISDICTION.

1. The jurisdiction of this Court is invoked under the Judicial Code, Section 240 (a), as amended by the Act of February 13, 1925, ch. 229, 43 Stat. 938 (28 USCA § 347).

2. The judgment of the Circuit Court of Appeals was entered on November 27, 1945 (R. 55-56).

III. QUESTIONS PRESENTED.

1. Where the Government illegally collected money prior to 1928 from a corporation under the guise of excise taxes, part of which it later refunded and made a deficiency income and excess profits tax assessment on the refund, is not the corporation entitled to recoup the moneys not refunded against the deficiency assessment?

2. Where the Government illegally collects money under the guise of excise taxes in one year, and the money is refunded in a later year, must not the money refunded be considered income for tax purposes in the year in which it was originally earned by the taxpayer rather than the year in which the Government paid the refund?

IV. STATEMENT OF THE CASE.

For the period of the seven years between March 1, 1919, and February 28, 1926, the Government illegally exacted 84 monthly payments from the respondent as excise taxes on the respondent's sales of electric storage batteries upon the erroneous theory that the batteries were parts of automobiles (R. 22, 27, 37). All of the assessments were upon the same type of batteries (R. 33). In 1935, as a result of litigation instituted by the respondent, the Government refunded the last 45 payments, these being the payments made between 1922 and 1926 (R. 24-25; 38). The Government treated this refund as income in the year 1935 and assessed a deficiency income and excess profits tax on the refund which, together with interest, amounted to $229,805.34 (R. 26, 38). The respondent sought to recoup against this assessment the first 39 monthly payments which had been made between 1919 and 1922 and which the respondent had not asked to recover in the prior litigation because of the bar of the statute of limitations (R. 7, 15, 29, 34, 38). The total amount of the payments made between 1919 and 1922 and which the respondent had absorbed itself is $534,205.04 (R. 33, 38). After the Government rejected the respondent's argument that it had a defense by way of recoupment to the entire deficiency assessment (and its additional argument that the refund received in 1935 was not 1935 income for tax purposes), the respondent paid this additional tax to the petitioner under protest (R. 26). After a claim for refund was denied, this suit was instituted to recover the payment and to obtain an adjudication of the validity of the recoupment defense and a determination of the question whether the refund was taxable as 1935 income (R. 38, 49).

The money the respondent paid to the petitioner and which it seeks to recover from him in this litigation was paid by him to the Treasurer of the United States, as required by law: 26 U.S.C. § 3950. The moneys the respond-

ent seeks to recoup were also paid by the Collector to the Treasurer of the United States, as required by law (R. 29, 33).

The District Court found that even after the Government is given credit for the respondent's income tax savings arising out of credits taken for the payment of all the excise taxes, the Government still has in its hands more of the respondent's money than the amount of the 1935 deficiency tax assessment (R. 44). The following calculation shows the situation exactly:

Respondent's 1919-1922 net payments of excise taxes (R. 33, 38)		$534,205.04
Respondent's income tax savings on 1919-1922 excise tax payments (R. 29)	$178,691.52	
Respondent's income tax savings on 1922-1926 payments (R. 23)	139,668.83	
		318,360.35
Net overpayment withheld by Government		$215,844.69
Additional 1935 income and excess profits taxes demanded and collected by Government (R. 26)		198,023.87
Overpayment by respondent after recoupment		$17,820.82

Although the total deficiency assessment paid in 1938 and based on the 1935 refund was $229,805.34, this was made up of additional tax of $198,023.87 plus interest thereon to the date of payment in 1938 of $31,781.47 (R. 26).

V. ARGUMENT.

SUMMARY.

Point 1. The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

Point 2. Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (1) they do not purport to affect the jurisdiction of Federal Courts and (2) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

Point 3. There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

Point 4. The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to recover from the petitioner moneys paid to him which he had no right to collect.

Point 5. The moneys paid to the respondent in 1935 as a refund of moneys illegally exacted from the respondent in the years 1922 to 1926 were improperly assessed as income in 1935 and should be treated as income in the earlier years.

Point 1.

The common law doctrine of recoupment as applied in actions at law for more than a century is applicable to the present facts.

1. The Facts and the Doctrine of Equitable Recoupment.

We start off in this case with the fact, proved by evidence and found by the Court (R. 33, 38), that the Government has collected from the respondent $534,205.04 under the guise of excise taxes on parts of automobiles, to which it was not entitled and no part of which has ever been returned. It is not the case of a miscalculation of the amount of a valid tax. No tax in any amount was due on the sale of respondent's storage batteries. The amount demanded by the Government and paid protestingly under duress (Request 17 and conclusion 5 affirmed: R. 32, 34, 45) was an illegal exaction from start to finish. It was money which, both in law and good morals, at all times belonged to the respondent but which the Government, by its superior power, compelled the respondent to pay to it.

In 1935 the Government recognized this with respect to other similar payments illegally exacted and repaid the respondent principal and interest totalling $1,395,515.35 to satisfy its judgment. The Government treated this entire repayment as income in the year 1935 and assessed additional income and excess profits taxes on it totalling $229,805.34.

These 1935 tax claims arose because of repayments by the Government of moneys it recognized had been illegally exacted. The respondent answers the Government's claim thusly: You cannot make me pay you money as taxes on the moneys you have disgorged when you still hold other moneys of mine (in a larger sum than the proposed tax) which you illegally exacted in the same manner as the money you have repaid but which I cannot compel you to disgorge at this late date. The least you can do is to use the rest of *my* money, to satisfy your claim for taxes on what I have made you pay back."

Would this have been an adequate defense to a suit by the Government for the additional 1935 tax? If so, the decision of the Circuit Court of Appeals is correct. The

present respondent's rights in that respect are not changed by reason of the fact that instead of waiting to be sued it paid the additional 1935 tax assessment under protest, filed a petition for refund, and then sued the same collector who received this payment to get it back. That point was settled in Bull v. United States (1935), 295 U.S. 247, discussed hereafter.

Judge Kirkpatrick found as a fact (by affirming the respondent's 20th request) that the respondent paid the Government, out of its own pocket, $534,205.04 for claimed excise taxes, which the Government still holds (R. 33, 45). He also stated this as a proved fact in his opinion (R. 38). It is stipulated that this money, as well as the additional 1935 income and excess profits taxes, were in usual course received by the Treasurer of the United States (R. 29).

On such facts it cannot be denied that the Government has been unjustly enriched at the respondent's expense, to the extent of the $534,205.04 it illegally extracted by duress from the respondent between 1919 and 1922. And when the Government finally recognizes that its gains are ill gotten and pays back part of them, on which it assesses another tax, every concept of equity and good conscience requires the Government to credit against this tax the additional moneys of the respondent which it still holds. Except for the bar of the statute of limitations, there is no doubt but that the respondent could have obtained a judgment for this $534,205.04, which represented the first 39 illegal monthly exactions, just as it did obtain a judgment for the amounts which represented the last 45 illegal monthly exactions. But while the statute of limitations does bar a direct action, general concepts of equity and good conscience require the application of the defense of equitable recoupment to the Government's claim for 1935 taxes.

The leading case on this question, with respect to Federal taxes, is Bull v. United States (1935) 295 U.S. 247. In that case the Commissioner assessed a deficiency

income tax against an executor for partnership profits earned after decedent's death. The executor had treated them as corpus of the estate and had paid estate tax on them. The Court held that even though the statute of limitations barred a recovery of the overpaid estate tax, the Government was required to credit it against the income tax claim, and that, inasmuch as the executor had actually paid the income tax, he was entitled to a judgment in the amount of the overpayment of estate tax. In that case the executor could recover only part of the income tax payment because the overpayment of estate tax was in a lesser sum. In the present case, the illegal exaction for "excise taxes" is much greater than the 1935 tax, which was paid, so the entire payment is recoverable.

Speaking for a unanimous court, Mr. Justice Roberts said (pp. 260-262):

> "In a proceeding for the collection of estate tax, the United States through a palpable mistake took more than it was entitled to. Retention of the money was against morality and conscience. But claim for refund or credit was not presented or action instituted for restitution within the period fixed by the statute of limitations. If nothing further had occurred Congressional action would have been the sole avenue of redress.
>
> In July, 1925, the Government brought a new proceeding arising out of the same transaction involved in the earlier proceeding. This time, however, its claim was for income tax. The taxpayer opposed payment in full, by demanding recoupment of the amount mistakenly collected as estate tax and wrongfully retained. Had the Government instituted an action at law, the defense would have been good. . . . While here the money was taken through mistake without any element of fraud, the unjust detention is immoral and amounts in law to a fraud on the tax-

payer's rights. . . . . If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely."

He added (p. 263):

"It is immaterial that in the second case, owing to the summary nature of the remedy, the taxpayer was required to pay the tax and afterwards seek refundment. This procedural requirement does not obliterate his substantial right to rely on his cross-demand for credit of the amount which if the United States had sued him for income tax he could have recouped against his liability on that score."

This doctrine of equitable recoupment was next approved by this Court in Stone v. White (1937) 301 U.S. 532 and applied in favor of the Government. A trustee had erroneously paid an income tax on income taxable to the beneficiary. After the Government's claim against the beneficiary had been barred, the trustee sued to recover his payment. Mr. Justice Stone said (p. 539):

"The Government, by retaining the tax paid by the trustees, is not reviving a stale claim. Its defense, which inheres in the cause of action, is comparable to an equitable recoupment or diminution of petitioner's right to recover. 'Such a defense is never barred by the statute of limitations so long as the main action itself is timely.' Bull v. United States, 295 U.S. 247, 262."

These two decisions have been cited very recently and with apparent approval by this Court in **Commissioner v. Gooch Milling and Elevator Co.** (1943) 320 U.S. 418, 421, in which, however, the scope of equitable recoupment was not before the Court for consideration.

The doctrine was applied in **Crossett Lumber Co. v. United States** (CCA 8, 1937) 87 F. (2d) 930, 932, in which the Court said:

> "Further, the equitable basis for the doctrine of recoupment has peculiar application to actions to recover taxes. The basis of the doctrine is that principle of natural justice which denounces a claim as unjust, immoral, and fraudulent when the claimant is at the same time wrongfully withholding money which in equity belongs to the other party."

In 1943 the Eighth Circuit Court of Appeals again applied the doctrine of equitable recoupment, this time in favor of the taxpayer, in **Gooch Milling & Elevator Co. v. Commissioner** (CCA 8, 1943) 133 F. (2d) 131. The Commissioner assessed an income tax deficiency for 1936 and the taxpayer sought to recoup an overpayment of 1935 income tax, refund of which was barred. The Board of Tax Appeals held it had no jurisdiction to apply the doctrine of equitable recoupment. The Circuit Court of Appeals reversed and held that (1) the Board did have jurisdiction, (2) the doctrine was applicable on the facts, and (3) in any event the Court itself had power to apply the doctrine. The Court said (p. 135):

> "In this situation a manifest wrong results if the administrative tribunal or the court is powerless to prevent an unjust enrichment of one of the parties before it. Recoupment is purely defensive and is equitable in its nature. It reduces the claim affirmatively urged so far as in reason and conscience it ought."

One judge dissented, but only on the question of the Board's jurisdiction, and on this "sole question" this Court

reversed: **Commissioner v. Gooch Milling & Elevator Co.** (1943) 320 U.S. 418. Significantly the Court said: "We are not called upon to determine the scope of equitable recoupment when it is asserted in a suit for refund of taxes *in tribunals possessing general equity jurisdiction.* cf. Bull v. United States, 295 U.S. 247, Stone v. White, 301 U.S. 532" (p. 421 Italics added). Consequently the decision of the Circuit Court of Appeals concerning *the facts to which equitable recoupment is applicable* stands unimpaired when such facts are established in a District Court, which does possess "general equity jurisdiction."

Judge Kirkpatrick said that **Dixie Margarine Co. v. Commissioner** (CCA 6, 1940) 115 F. (2d) 445 "is on all fours with the present case" (R. 43). In that case the Government illegally collected moneys between 1923 and 1931 from Dixie on the erroneous theory its products were taxable under the Federal Oleomargarine Act. In 1932 the Government paid back the moneys illegally exacted between 1925 and 1931 but did not pay back $87,412 which had been collected between 1923 and 1925, recovery of which was barred by the statute of limitations. The Commissioner then assessed a deficiency 1932 income tax on the refunds and Dixie sought to recoup the amounts illegally exacted during the years 1923 to 1925. The case arose in the Board of Tax Appeals and it rejected the defense: 38 B.T.A. 471. The Sixth Circuit Court of Appeals reversed.

In the case at bar the Government concedes that this case is against it but contended in the Circuit Court of Appeals that Judge Arant's opinion does "not even have the status of dictum" (Petitioner's Brief in the C. C. A. p. 27). The Government sought unsuccessfully in the Circuit Court of Appeals to justify this summary waiving aside of a unanimous 1940 decision of the Sixth Circuit Court of Appeals by the following ingenious and wholly fallacious chain of reasoning:

> The Dixie case arose in the Board of Tax Appeals. The Board refused to apply the doctrine of equitable recoupment. The Court reversed. In the Gooch case the Supreme Court held, three years later, that the Board had no jurisdiction to hear such a defense and that the Eighth Circuit Court of Appeals had erred in deciding the contrary. Ergo, the Sixth Circuit Court of Appeals erred in the Dixie case in reversing the Board and directing it to apply that doctrine and its decision is now discredited.

The fallacy of this reasoning is that it does not distinguish between the factual situation to which the doctrine of equitable recoupment is applicable and the jurisdiction of the particular tribunal in which the facts are presented to apply that doctrine. In view of the Gooch case we concede that on an appeal from the Tax Court, which is the successor to the Board of Tax Appeals (but not on an appeal from a District Court), a different result than that reached in the Dixie case would now be required, but only because of the limited statutory jurisdiction of the Tax Court. However, no jurisdictional question was considered in the Dixie case either by the Board or by the Court. The opinion is concerned solely with determining whether the facts in that case (which most certainly are "on all fours", as Judge Kirkpatrick said, with the present facts) called for the application of equitable recoupment. The Court there held that they did. On this question of substantive law the case is as good authority today as the day it was decided; and as Judge Kirkpatrick sat as a District Court which does possess "general equity jurisdiction" he quite properly looked upon the Dixie case as persuasive authority and "directly in line with the trend shown by the decisions of the Supreme Court" (R. 43). We submit that this case was correctly decided on the merits and that Judge Arant's opinion fully sustains the conclusions he reached. It is persuasive authority of un-

usual weight because it accords so fully with established principles of equity and fair dealing.

Judge Kirkpatrick well said: "the equities are so plain as to admit of no disagreement among just and reasonable men. Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been illegally compelled to pay, and I think that the decisions of the courts fully justify such a solution" (R. 42-43). The Circuit Court of Appeals quoted from this language and said "as to the fairness of the matter, we agree with the District Court . . .": R. 51.

Other decisions, in addition to those already cited, which sustain the judgment in this case include **Dunigan v. United States** (Ct. of Cl. 1938) 23 F. Supp. 467 and **Mills v. United States** (D.C. N.Y., 1940) 35 F. Supp. 738.

2. The Scope of the Doctrine of Equitable Recoupment.

The Government seeks to avoid the application of the doctrine of equitable recoupment to the present facts by contending that the payments "sought to be recouped, did not arise out of the same transaction as the income taxes for 1935 . . ." (Petitioner's Brief, pp. 8-9).

"What meaning have the Courts given to the words "the same transaction"?

"A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used." [1]

This Court itself has said: " 'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship": **Moore v. New York Cotton Exchange** (1926), 270 U.S. 593, 610. The Court was there considering the meaning of the word in Equity Rule 30 permitting "any counter-

[1] *Towne v. Eisner* (1918), 245 U.S. 418, 425, per Holmes, J.

claim arising out of the *transaction* which is the subject-matter of the suit." The Court construed it broadly because "To hold otherwise would be to rob this branch of the rule of all serviceable meaning."

In an early case on recoupment, part of the language of which was later adopted by Waterman in his text book definition, the Illinois Court said that recoupment "adjusts by one action adverse claims growing out of the same subject matter. . . . It is not necessary that the opposing claims should be of the same character. . . . *It is sufficient that the counterclaims arise out of the same subject matter, and that they are susceptible of adjustment in one action*": Stow v. Yarwood (1853), 14 Ill. 424, 426-27 (Italics added).

The italicized language was incorporated into Waterman's discussion distinguishing recoupment from set-off. He said recoupment is "confined to matters arising out of, and connected with, the transaction or contract upon which the suit is brought" and went on to repeat the italicized language from the Stow case: **Waterman on Setoff, Recoupment and Counterclaims** (2d ed. 1872), p. 480.

In **Bull v. United States**, supra, Mr. Justice Roberts said "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded": 295 U.S. 262.

In **Mills v. United States**, supra, the Court said "The doctrine of recoupment is not limited to a claim arising directly from the particular contract sued upon. It is sufficient if it arises out of the same subject matter, and that the claims are susceptible of adjustment in one action": 35 F. Supp. 739.

In **Crossett Lumber Co. v. United States**, supra, Judge Thomas said "the equitable basis for the doctrine of recoupment has peculiar applications to actions to recover taxes": 87 F. (2d) 932.

In Mr. McConnell's article on "The Doctrine of Recoupment in Federal Taxation" (1942), 28 Va. L. Rev. 577,

he said that "recoupment is at present an appropriate device to render fundamental justice and equity in situations where a strict adherence to the terms of the statutes of limitation would result in unfairness."

In the light of these expressions let us examine the present facts. During the 7 years between March 1, 1919 and February 28, 1926, the Government illegally exacted 84 monthly payments from the respondent. They were all based on the same taxing statute because Section 900 of the Revenue Act of 1921, levying an excise tax on parts of automobiles, was merely a reenactment of Section 900 of the Revenue Act of 1918. All 84 payments were based on respondent's sales of electric storage batteries. The storage batteries sold by the respondent and upon which "excise taxes" were paid during the first 39 months were the same type of batteries sold by respondent during the last 45 months of the 7-year period (This fact is specifically covered by the plaintiff's 23d Request for Fact Findings which was affirmed by the Court: R. 33, 45). When the Government refunded the last 45 payments and assessed a 1935 deficiency income tax on the refund the respondent asked to recoup the first 39 payments.

This exactly fits this Court's statement, quoted above from the Moore case, that the word "transaction" "may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship."

The procedural requirement that the original demand and claim for recoupment be "susceptible of adjustment in one action" is clearly met.

The recoupment doctrine came into the law to promote justice. It should be liberally applied to accomplish that end wherever that can be done without undue procedural or administrative difficulty and no rule of public policy prevents it. It is obvious that unless its convenient application to this case is sustained the respondent can derive no benefit from the more than half million dollars of its

money, obtained originally by duress, which the Government holds. Words are devices to promote the transmission of thought. The "living thought" that lies within "recoupment" cannot be stifled by mere pedantry.

3. Comments Upon the Petitioner's Argument Concerning Recoupment.

Acceptance of the petitioner's argument requires one to forget that "The doctrine of recoupment is based on concepts of fairness." (R. 50-51). Petitioner argues at length that the present facts are different from those in *Bull v. United States* and in *Stone v. White*, and the first reason stated in the petition for certiorari (p. 8) was that the decision in the present case is "an unwarranted extension of the principle of the *Bull* case." But the latter case did not purport to define the scope of recoupment in tax cases or set forth the limits of its application, other than by saying "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded": 295 U.S. 247, 262. This Court did not there define the word "transaction". The important thing was that "the United States through a palpable mistake took more than it was entitled to" and "Retention of the money was against morality and conscience": 295 U.S. 247, 260. For this reason the recoupment defense was sustained. The language just quoted is no less apposite in describing the facts in the present case. As recoupment "is a product of judicial action" (Petitioner's Brief p. 19, note 7) it has sufficient flexibility to perform the function for which it was created even though the particular facts vary from case to case. The minute that ceases to be true and the rule is viewed as having the rigidity of a fifteenth century writ it becomes a deterrent, rather than an aid, to obtaining a fair and just result.

Much of the petitioner's argument disregards the fact that recoupment grew up in the common law and need not

look to legislation for any support. Petitioner stresses that Sections 3228 and 3226 of the Revised Statutes "form part of a system of corrective justice in respect of the assessment and collection of erroneous or illegal taxes" and that "this system . . . was intended to comprehend the entire subject, including all claims for refund" (Petitioner's Brief, p. 13). The answer to that is that after this system was established this Court unanimously decided the *Bull* case in 1935.

Of course those statutory limitations barred any direct claim or suit for refund of the respondent's half million dollars the Government had compelled it to pay and wrongfully retained. But the statement that "The courts have not been vested with general jurisdiction to grant a refund of taxes upon equitable principles where the taxes have been exacted according to law" (Petitioner's Brief p. 17) confuses (1) the Court's lack of power to grant a judgment in the taxpayer's favor in a too late suit by him to recover taxes erroneously paid with (2) the Court's recognized power to permit the taxpayer to plead recoupment by way of defense when the Government sues to recover another tax arising out of the same transaction, or "the same subject matter." And if Collector Rothensies had attempted to discharge his "statutory duty to collect the (1935) assessment" (Petitioner's Brief p. 16) by suing the respondent in the District Court that Court would have had "general equity jurisdiction" to hear and apply the recoupment defense. So too, under the *Bull* case, the District Court *does* have power to "grant a refund . . . . upon equitable principles" of the 1935 income taxes which respondent paid and then sued to recover in order to raise the recoupment defense. Hence it does *not* "follow that there could be no recovery by suit of those (1935 income) taxes" (Petitioner's Brief, p. 17).

The petitioner further disregards the reason for the rule of recoupment by arguing that the rule as applied in the *Bull* case is not applicable here "because recovery of

the excise taxes was barred when the Commissioner proceeded to collect the income tax" (Petitioner's Brief, p. 18), whereas in the *Bull* case "recovery was predicated on the fact that when the Government proceeded against the taxpayer to collect a second tax on the identical sum of money, refund of the first tax was not barred" (p. 21). As we read the opinion it seems clear that recovery was *not* predicated on the stated fact, nor was it a controlling fact. Certainly there is nothing in the opinions in *Stone v. White* or in McEachern v. Rose (1937) 302 U.S. 56 to suggest that such fact is of any legal significance. Indeed, in the latter case, in which the Government's claim to recoup was based on a claim which *was* barred when the taxpayer took action to collect the overpaid income tax Justice Stone said: "We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result": 302 U.S. 56, 59. The petitioner's argument is certainly contrary to that assumption. It is also contrary to the statement in the *Bull* case, which was quoted with approval in *Stone v. White* that the defense of recoupment "is never barred by the statute of limitations so long as the main action itself is timely": 295 U.S. 247, 262. Indeed, it is difficult to reconcile petitioner's argument on this point with his further statement (p. 19, note 7) that "Since recoupment *is purely defensive* and arises out of and inheres in the plaintiff's claim and advances reasons why the court should not use its processes to enforce an inequitable claim of the plaintiff, *the defense is considered to survive as long as the plaintiff's cause of action exists, although an affirmative action by the defendant upon the subject of the claim may be barred by the statute of limitations*" (Italics added.)

This accurate statement is also the answer to petitioner's conclusion that "If the purpose of a statute of limitations is repose, it is completely frustrated by the decisions below" (p. 23). One can keep his repose and the other's money as well, but when he chooses to seek more money

from the other he cannot object to that slight disturbance of repose which may result from the defensive plea of recoupment. The Government could have continued to enjoy complete repose even though it had in its pocket some $534,000 of respondent's money which didn't belong to it. It chose to disturb that repose by asking the respondent for $229,000 more out of the partial refund of the illegally collected excise taxes. That disturbed the respondent's repose also and led it to remind the Government about the other $534,000. This amount of disturbance of repose is inevitable in any recoupment case. When the statute of limitations has not run there is no need for the rule of recoupment; the defense of set-off is sufficient.

Petitioner says in his brief (p. 25) that "the principle of recoupment may serve a desirable end". (This seems inconsistent with the position earlier taken (p. 13) that the statutes alone were "intended to comprehend the entire subject".) Petitioner adds that recoupment "should not be applied in such a manner as to result in a direct conflict with the statutory purpose" and that as applied in this case it does "result in such conflict" (p. 26). But the facts do not show a Congressional intent in conflict with the result in this case. The facts are that seven years after the Revenue Act of 1928 was enacted (which petitioner claims destroyed a taxpayer's defense of recoupment) this Court recognized the taxpayer's right of recoupment in the *Bull* case. The report of the Committee on Finance on Section 820 of the Revenue Act of 1938 (quoted in Petitioner's Brief p. 25, note 11) which came three years later does not disapprove of the *Bull* case or of the rule of recoupment. On the contrary it refers to the need for legislation "*to supplement* the equitable principles applied by the courts. . . ." The fact that this supplementary legislation dealt with one phase of the situation involving only income tax adjustments reveals no statutory purpose to destroy the recoupment doctrine in tax cases or limit the courts in determining its proper scope. Section 820, which

provides for mitigation of the effect of the statute of limitations in income tax cases where there has been an erroneous treatment of an item of income, deduction, or basis of property in another year and permits recovery of a refund notwithstanding the fact that the statute of limitations has run, has nothing to do with this case. It is concerned solely with adjustments of income taxes in taxable years subsequent to January 1, 1932, and the respondent's right to recoup payments of *excise* taxes illegally collected arose long before that date. Judge Kirkpatrick decided that Section 820 did not lessen any right which accrued before January 1, 1932 (R. 44). The same construction has been given to it by the Court of Claims (**Lynchburg Coal & Coke Co. v. United States** (1942) 47 F. Supp. 916, 921) and by Judge Evans in the Seventh Circuit: **American Light & Traction Co. v. Harrison** (CCA 7, 1944) 142 F. 2d 639, 645.

Petitioner says that "The doctrine of recoupment has been applied primarily in cases where there has been *inconsistent* treatment for tax purposes of the same item or event . . ." (Petitioner's Brief p. 27). This sort of case is an obvious example of a type of case likely to arise. But the tax cases, particularly in this Court, are too few to establish any definite boundaries of inclusion or exclusion. To limit recoupment to this one type of case, just because it was the first to arise in tax litigation, requires one to look so intently at the facts of the case as to forget to look up and see the rule emerging from them. It reminds one of the earlier torts decisions denying a manufacturer's liability to a third person unless his injury came from something intended "to destroy, preserve or affect human life" and the cases involved foods, drugs, chemicals and firearms. It remained for Judge Cardozo in **MacPherson v. Buick Motor Co.** (1916) 217 N.Y. 382 to show that these were merely *examples* of situations in which the rule of liability should be applied and that it was equally applicable to other sets of facts.

Certainly if "an inconsistent treatment of the same item" which causes a "particularly harsh" result when the statute of limitations is applied is the reason which justified the Court in applying recoupment (as petitioner says on page 28 of his brief) there is no less reason for relief in the present case. It is no less "particularly harsh" for the Government to say to respondent "I shall pay you back some of the excise taxes I illegally compelled you to pay, but I shall get part of that back by taxing you on the refund; and I shall give you no credit whatever for the taxes I still withhold even though they exceed the new tax on the refund."

Petitioner errs in his Brief when he states "that there was no inequity in the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, for the taxpayer had deducted those excise taxes in its income tax returns for the years 1922 to 1926 and thereby had secured a tax benefit equal to the 1935 income taxes" (p. 30). Actually the income tax saving for 1922-26 was $139,668.83 (R. 23) whereas the 1935 assessment was $198,023.87 and with interest added totalled $229,805.34 (R. 26).

But more than this, petitioner in his statement omits reference to the fact that the Government had previously illegally collected from the respondent $534,205.04 under the guise of excise taxes to which it was not entitled and no part of which has ever been returned. The inequity arises, not because of the imposition of the income taxes upon the refund of the 1922 to 1926 excise taxes, but upon the failure of the Government to credit against that imposition of income taxes the funds illegally exacted as excise taxes for the years 1919 to 1922 in the amount of $534,205.04, which amount was more than sufficient to cover the income tax for 1935 and the tax benefit by reason of the deduction of the excise taxes in income tax returns for the years 1922 to 1926. Both Courts below agreed as to the inequity of this situation (R. 43, 51).

Finally, the petitioner views with alarm applying re-

coupment to the present case because it offers "almost limitless opportunities for circumventing the statute of limitations and the periodical system of federal tax accounting. . . ." (Petitioner's Brief p. 25). "Almost limitless opportunities" in fact comprise only opportunities to plead recoupment defensively in cases in which the defense (a) arises "out of some feature of the transaction upon which the plaintiff's action is grounded" (295 U.S. 247, 262), and (b) can "be expediently tried with the plaintiff's case" (R. 50) and (c) is necessary to prevent unjust enrichment. In the present case two courts have said that "Every consideration of fair dealing demands that the taxpayer be credited as against its present liability with the taxes which it has been *illegally compelled* to pay, . . ." (R. 43, 51 Italics added). Is the petitioner's quoted opinion as to the future results of granting credit on such facts a sound one? Our opinion is that experience will prove that the forebodings of disaster came from the tongues of false prophets.

Point 2.

Sections 608(a) and 609(b) of the Revenue Act of 1928 do not destroy respondent's substantive right of recoupment because (1) they do not purport to affect the jurisdiction of Federal Courts and (2) they do not destroy a substantive right of recoupment which a taxpayer had on their effective date.

Point 3.

There is no basic inconsistency or confusion in the decisions of this Court when properly analyzed and understood.

1. The Sections do not Change the Jurisdiction of Federal Courts.

The first reason why these sections do not bar the taxpayer from asserting the doctrine of equitable recoupment in a court possessing general equity jurisdiction is that they were enacted as "Administrative Provisions" to

govern the Commissioner of Internal Revenue in making "a refund" or giving "a credit". They do not purport to deprive a court of jurisdiction to hear and determine a plea of recoupment. The language used is inapplicable to a court which does not make "a refund" or give "a credit" in a lawsuit but enters a judgment. It is significant that these sections are a part of "TITLE IV—ADMINISTRATIVE PROVISIONS" of the Revenue Act of 1928, which contains numerous other purely administrative provisions. It is also significant that in the Internal Revenue Code of 1939 these sections (3774(a) and 3775(b)) are found under "SUBTITLE D, GENERAL ADMINISTRATIVE PROVISIONS" and in "*Chapter 37, Abatements, Credits and Refunds*". Such headings are pertinent in interpreting a statute: 50 *American Jurisprudence* 467, 468; **Knowlton v. Moore (1900)**, 178 U.S. 41. If Congress had intended to take away from the Courts the power to apply the doctrine of recoupment it would have been a simple matter to have done so in clear language and in an appropriate section, such as Section 617 of the Revenue Act of 1928 which deals with "Jurisdiction of Courts".

If Congress had intended to take away the jurisdiction of Federal Courts to apply the doctrine of equitable recoupment in tax cases it would have said "No Court of the United States shall have jurisdiction to hear and adjudicate a plea of recoupment in a tax case" or words of similar import. That is the sort of language which is found in the Norris-LaGuardia Act which withdrew from Federal Courts most of their jurisdiction to give equitable relief in labor disputes: 29 U.S.C. §§104, 105, 107.

Such expressions as "credit of an overpayment", "credit against a liability" and "refund", are typical Bureau of Internal Revenue expressions frequently found in mimeographed directions to Collectors of Internal Revenue. Certainly they are not sufficient to deprive a District Court of its established jurisdiction to apply the ancient doctrine of recoupment in favor of a taxpayer.

In **Lyeth v. Hoey** (CCA 2, 1940), 112 F. (2d) 4, 9-10 (discussed thereafter), Judge Clark, in a dissenting opinion, said on this point:

> "Had it been intended to prohibit any credit for any federal tax after the period of limitation had run, the natural course would have been to express this prohibition directly. Thus it could have been provided that a barred tax could be neither affirmatively collected nor used as an offset against the taxpayer's claim for refund. But this statement seems studiously to have been avoided. Instead the statute refers to the converse situation, to make void not the barred claim, but the refund credit. This backhanded form of statement is not clear unless it is read as emphasizing the administrative process of making a credit. A direct payment of the barred claim is made recoverable under the earlier section, § 607; so here it is added that the attempt to make a credit towards it is simply a void act.
>
> "Such careful use of terms would be unusual if credit meant substantially any tax claim, as my brothers view it. It does, however, tie in with the limited and careful use of the term credit in the revenue laws, where it does not appear as a synonym for general setoff. It does appear in § 322(a) with reference to the income tax only as pointed out above; its use elsewhere is limited. . . .
>
> "In the revenue laws, therefore, the word credit seems to be a word of art, having a specific denotation, rather than a word of broad and indefinite generality. This is more than a mere matter of adding or subtracting payments or refunds, or of the form which the checks to settle the balance should take. It is a matter of substance, to wit, what agency of government has the responsibility of passing on difficult questions of equitable recoupment beyond the fairly

simple situations covered by section 322(a). To date the principles of such recoupment have been only partially developed by the Supreme Court. It seems, therefore, that those are problems for the courts."

However, where a taxpayer sues to recover an admitted overpayment there are strong reasons of public policy against permitting the Government to defeat the action by contending it has not been unjustly enriched by the overpayment. It is of enormous administrative importance in the collection of taxes for taxpayers to feel that they can make prompt payment of taxes claimed from them with assurance that if that particular tax is excessive the overpayment will be refunded or credited against another collectible tax liability. *A taxpayer who pays a tax demand should not be in a worse position than one who compels the Government to proceed against him.* The latter taxpayer will successfully defend the suit to collect the over-assessment, and, of course, he will not have to pay some earlier barred liability. *The good citizen who promptly pays the taxes demanded of him should be equally well off when he seeks a refund of his overpayment.* It would not only be unfair but enormously impede the collection of taxes if the Commissioner of Internal Revenue could by collection of amounts not due or barred by limitations place himself in a better position to *keep* such money than he would have been in to *collect* it, had he been compelled to sue. If he could thus improve his position by getting the money into his own hands it would become necessary to grant injunctions against the collections of overassessments, and the prompt and orderly collection of taxes would be thrown into a state of chaos.

Such reasons of policy seem to be back of Sections 607 and 609(a) of the Revenue Act of 1928 which provide that a payment made after the time within which it could have been collected "shall be considered an overpayment and shall be credited or refunded to the taxpayer" and which

prohibit the Commissioner from crediting the taxpayer's money against some unpaid tax, recovery of which is barred by limitations.

It is obvious that the reasons of policy behind Sections 607 and 609(a) which require the Commissioner voluntarily to refund the overpayment and which prohibit him from contending that *ex aequo et bono* the taxpayer is not entitled to recover, apply with equal force when the Commissioner disobeys the statutory mandate and the taxpayer brings suit to recover his overpayment. They bar the Government from contending it has not been unjustly enriched by getting possession of the overpayment.

It would be shocking to think that the Commissioner, by violating his statutory duty under Sections 607 and 609(a) to refund an overpayment and thereby compelling the taxpayer to enforce his statutory right by suit, could in that suit defeat the right of recovery by pleading he was not unjustly enriched in keeping the money the statute commanded him to pay over. If that could be done the Commissioner could completely frustrate the intent of Congress in every case by always compelling the taxpayer to sue and in each suit set up the so-called "equitable defense". No court should assist the Commissioner (or one of his Collectors of Internal Revenue) to evade his statutory duty by such a specious resort to rules of equity and good conscience. This thought was forcibly presented to the Supreme Court in the brief of an *Amicus Curiæ* in the much misunderstood case of **McEachern v. Rose** (1937), 302 U.S. 56, and was accepted by the Court. Mr. Justice Stone referred to Sections 607 and 609(a) of the act and said: "These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation." (p. 60)

In view of the confusion among the profession as to what this case really stands for and the scope of its author-

ity, we have set forth a complete analysis of it in an appendix to this brief which appears on pages 1a-9a. It must be clearly understood that that case dealt solely with determining whether *the Government* could defend a suit to recover an overpayment by raising a general equitable defense.

An entirely different situation is presented when the Commissioner makes a deficiency assessment and seeks its collection from the taxpayer. If he has in his possession money he has illegally collected from the taxpayer arising out of the same transaction, Sections 608(a) and 609(b) may bar *him* from crediting it against the deficiency. But when the Collector sues the taxpayer to recover the deficiency assessment, there is no reason of policy to prevent the taxpayer from pleading recoupment. An administrative prohibition on the Commissioner does not affect the power of the Court to apply a doctrine which has been uniformly applied by Courts for many, many years. No public policy opposes such action by the Court. On the contrary, the public policy that justice should be done in our Courts requires the Court to permit the taxpayer to recoup against the deficiency tax claim.

The failure to see this distinction has caused most of the confusion with respect to the scope of the McEachern case. Its application should be limited *to what it held*, i.e., that in a suit by a taxpayer to recover an overpayment *which the statute entitles him to receive*, the Government cannot raise the equitable defense that keeping the overpayment does not result in unjust enrichment. But where the taxpayer is resisting a deficiency assessment under the pleaded defense of recoupment, then Bull v. United States is the controlling authority. It should not be overlooked that the suit in the Bull case was instituted *after* the effective date of the Revenue Act of 1928 but, nevertheless, the taxpayer's right of recoupment was sustained.

When the respective scope and application of these two cases is understood the apparent conflict between them

disappears and the cases fall into distinguishable patterns. In **Lyeth v. Hoey** (CCA 2, 1940), 112 F. (2d) 4, the taxpayer sued to recover an overpayment of 1933 income tax and the Government sought to recoup a barred estate tax deficiency assessed in 1938 (Note that the transaction was after the 1928 act became effective). The Court quite properly followed McEachern v. Rose which was the same type of case. Judge Clark's dissenting opinion, quoted on page 24 of this brief, correctly construed Sections 607, 608 and 609 as administrative provisions but overlooked the public policy which bars the Government from evading Sections 607 and 609(a) by forcing the taxpayer to sue. However, his dissenting opinion is entirely apposite to the facts presented in this case where no such policy is applicable. In several other cases the Government has unsuccessfully sought to raise an equitable defense to taxpayers' actions to recover overpayments: **American Light & Traction Co. v. Harrison** (CCA 7, 1944), 142 F. (2d) 639; **Grand Central Public Market v. U. S.** (D.C. Cal. 1938), 22 F. Supp. 119; **Crawford v. Heiner** (D.C. Pa. 1938), 23 F. Supp. 240; **Rotenberg v. Shechan** (D.C. Mo. 1943), 48 F. Supp. 584.

The two decisions in the Court of Claims cited on page 32 of the petitioner's brief are both cases in which the taxpayer did not prove that he had ever made a true overpayment out of which any right of recoupment could arise and, in addition, different transactions were probably involved. There is language, however, in the opinions which shows that the Court failed to see the distinction between cases falling within the rule of McEachern v. Rose and those falling within the rule of Bull v. United States.

The petitioner has not cited a single case in which a taxpayer who has clearly proved the Government had his money has not been permitted to recoup it where the elements of recoupment were present. In other words, no taxpayer who had a defense of recoupment, on proved

facts, has been barred from asserting it by the Act of 1928.

It is interesting to note the dissenting opinion of Judge Evans in **American Light & Traction Co. v. Harrison,** supra, in which the Court properly applied McEachern v. Rose and refused to permit the Government to recoup a barred 1928 tax against the taxpayer's claim to get back an overpayment of 1933 taxes. Judge Evans overlooked the rule of policy which bars the Government (but not the taxpayer) from pleading recoupment in a tax case, and argued strongly for the doctrine of recoupment. His failure to see that policy requires application of recoupment in a Bull case situation and rejection of it in a McEachern case situation, led him to describe the present law as "vexatious, perplexing and confusing". His opinion is a strong plea to apply recoupment to the facts of this case.

In adition, the decisions since McEachern v. Rose in which the taxpayer pleaded recoupment, have applied the Bull case and allowed the defense: **Dixie Margarine Co. v. Commissioner** (CCA 6, 1940), 115 F. (2d) 445 (which is on "all fours" with the present case and in which the Court followed the Bull case); **Gooch Milling & Elevator Co. v. Commissioner** (CCA 8, 1943), 133 F. (2d) 131, reversed on the "sole question" of jurisdiction in 320 U.S. 418; **Dunigan v. U. S.** (Ct. Cl. 1938), 23 F. Supp. 467. It may be noted that while this Court confined its decision in **Commissioner v. Gooch M. & E. Co.** (1943), 320 U.S. 418, to the jurisdictional question, it cited the Bull case with apparent approval and did not mention McEachern v. Rose. That assumes added significance in the light of the fact that the Government's brief in the Supreme Court in the Gooch case said on page 28: "Moreover, the doctrine of recoupment as set forth in the Bull case and Stone v. White, supra, is not available to the taxpayer, in any event, by reason of McEachern v. Rose."

2. The Sections are not Retroactive and do not Destroy Substantive Rights.

It seems clear that Sections 608(a) and 609(b) have no application to the present law suit. This is so for still another reason. When the Government forced the respondent to make payments to it in 1919, 1920, 1921 and 1922, at the moment each payment was made a legal right to get it back arose. The statute of limitations prevents the respondent from asserting that right in an offensive suit. But the right continues to exist and may be asserted defensively in a plea of recoupment. That it is a valuable substantive right is evident: it constitutes a complete defense to a deficiency assessment claim of $229,000. Surely a 1928 statute containing directions to the Commissioner concerning "credits" and "refunds" did not destroy the plaintiff's existing right to plead recoupment. At the most it did no more than close the Commissioner's ear to such an argument, and require the plaintiff to resort to a Court possessing general equity jurisdiction, to assert his right of recoupment. A statute will not be construed as destroying an existing right unless the legislative intent to do so is expressed in clear and unmistakable language, and even then the statute faces constitutional obstacles: 50 *American Jurisprudence* 500. "Every reasonable doubt is resolved against a retroactive operation of a statute": **Valleytown Tp. v. Women's Catholic Order** (CCA 4, 1940), 115 F. (2d) 459, 462; **U. S. v. St. Louis etc. Ry. Co.** (1926) 270 U.S. 1; **Hassett v. Welch** (1938), 303 U.S. 303; **Claridge Apartments Co. v. Commissioner** (1944), 323 U.S. 141.

The petitioner cites no case holding that Section 608, even if applicable, which it is not, should be applied retroactively to destroy a right of recoupment which existed on the effective date of the act.

Section 609(c) which provides "The provisions of this section shall apply to any credit made before or after the

enactment of this act" did not cut off a then existing right of recoupment. Further, this entire subsection (c) was completely eliminated from Section 609 when that section became Section 3775 of the Internal Revenue Code of 1939. There was also eliminated from Section 607 the parenthetical clause "whether before or after the enactment of this act", which is now Section 3770(2) of the Code. That code is the present law and was the law when this suit was started in 1943. It was the law when the claim for refund was filed in 1940 and denied in 1941.

In the one other case in which the question of the retroactive effect of the Act of 1928 has been considered, the Court held that even the Government could in 1941 assert a right of recoupment which existed when the act was passed: West Va. Pulp & Paper Co. v. McElligott (D.C. N.Y. 1941), 40 F. Supp. 765, 771. Judge Burke said:

> "The taxes sought to be recovered by these suits were paid long before the enactment of Sections 607 and 609. It is the policy of Section 609(a) 'to stimulate voluntary payment of taxes by giving the taxpayer an immediate refund right free from the danger that it will be credited against a stale deficiency'. Harvard Law Review, Vol. 52, 1939, Page 498. A consideration of this policy seems to indicate that Sections 607 and 609(a) should not be construed to have the retroactive effect of taking away the equitable defense of recoupment as applied to claims for refund of taxes assessed and paid before the enactment of those sections, which defense would otherwise be available. Neither McEachern v. Rose nor Lyeth v. Hoey, 2 Cir., 112 F. 2d 4, dealt with the retroactive aspect of the application of those sections and may not be considered as authorities holding that recoupment may not be had as to claims for refund of taxes assessed and paid before the enactment of those sections. 'A statute will not be construed as taking away a common-law right existing at the date of its enactment, unless that result

is imperatively required.' Texas & Pacific R. R. Co. v. Abilene Cotton Oil Co., 204 U. S. 426, 27 S. Ct. 350, 354, 51 L. Ed. 553; White v. Hopkins, 5 Cir., 51 F. 2d 159."

This decision was cited with approval by both of the courts below (R. 44, 53).

Point 4.

The rule that a taxpayer may not recover from one Collector of Internal Revenue moneys wrongfully paid to a predecessor collector has no application to the present case because the respondent only seeks to recover from the petitioner moneys paid to him which he had no right to collect.

The respondent sued the petitioner to recover from *him* the sum of $229,805.34 which had been paid to *him* on December 3rd, 1938. The theory is that *he* illegally collected this money as Collector of Internal Revenue because no money was owing to the Government by the respondent. The judgment of the Court below is that the respondent is entitled to recover back from the petitioner the money paid to *him*. The judgment does not require him to pay back moneys paid to any other Collector.

The petitioner's argument on pages 39 to 41 of its brief ignores the facts in the case and the fact that in tax litigation the position of the parties to the suit is generally the reverse of that in ordinary litigation.

The mere fact the Government was entitled to *assess* a deficiency tax for 1935 (the propriety of which is discussed infra) does not mean that it was entitled to *collect* it. The fact is the Government was not entitled to collect a penny of that assessment because the respondent's right of recoupment was a defense to the entire claim. Consequently no part of this assessment could be lawfully collected. However, rather than face the Government's exercise of its power to collect the assessment by summary process, the respondent paid the assessment under protest

and then sued to establish its right of recoupment. The petitioner Rothensies had no right to receive the payment made to him by the respondent and he had no right to keep it. He is only being required to pay back what *he* wrongfully received and wrongfully retained.

The petitioner contends that the respondent has worsened its position by paying the assessment and suing to recover it, and that by so doing it can no longer assert the defense of recoupment it could have made as a defendant in a suit brought by or on behalf of the Government. The established law is contrary to this contention and it was settled by Mr. Justice Roberts in Bull v. United States, supra, when he said at pages 262-263 of the U. S. reports:

> "The circumstance that both claims, the one for estate tax and the other for income tax, were prosecuted to judgment and execution in summary form does not obscure the fact that in substance the proceedings were actions to collect debts alleged to be due the United States. *It is immaterial that in the second case, owing to the summary nature of the remedy, the taxpayer was required to pay the tax and afterwards seek refundment.* This procedural requirement does not obliterate his substantial right to rely on his cross-demand for credit of the amount which *if the United States had sued him for income tax* he could have recouped against his liability on that score" (Italics added).

The money the respondent paid to this petitioner on December 3, 1938, and which it seeks to recover from him was paid by him to the Treasurer of the United States, as required by law: 26 U.S.C. §3950. The moneys the respondent seeks to recoup were also paid by the then Collector to the Treasurer of the United States as required by law. This is stipulated (R. 29). In addition, in this case a certificate of probable cause has been filed in the District Court (R. 46) so the judgment against the peti-

tioner will be paid by the Treasurer of the United States out of the moneys of the respondent now in his possession.

The Circuit Court of Appeals well said: "A recoupment claim in a tax case is not a suit against a collector at all, but only a defense against what the collector asserts. If this is technical, it is no more so than the argument which it answers" (R. 54).

It may also be noted that in *Stone v. White* this Court allowed the Government to recoup against a trustee a tax which should have been paid by the beneficiary. Different persons but the same interest were involved. In this case the Government is the one really interested because it received the excise taxes and also assessed and received the 1935 income taxes.

Point 5.

The Moneys Paid to the Respondent in 1935 as a Refund of Moneys Illegally Exacted from the Respondent in the Years 1922 to 1926 Were Improperly Assessed as Income in 1935 and Should be Treated as Income in the Earlier Years

In this case "every consideration of fair dealing" (R. 43, 51) calls for an affirmance of the judgment. We believe that what we have already said in this brief establishes the respondent's right, under rules of equity and good conscience, to hold its judgment. At most, the petitioner can only urge technicalities as reasons for a reversal, such as "the same transaction" rule in recoupment and the effect of the Act of 1928. In view of this, we are entitled to point out to this Court a technical reason for affirming the judgment and thereby accomplishing the result demanded by considerations of fair dealing.

We urged in the courts below that the payment of $1,395,515.35 received by the respondent on October 15, 1935, could not be treated (except for interest in 1935) as 1935 income. The courts held to the contrary (R. 39-42,

49). It may be noted that it was unnecessary for the courts below to decide this issue in respondent's favor because they held for the respondent on other grounds. We believe the point is technically sound and we raise it again here as a reason to sustain the judgment. In so doing we merely assert "additional grounds why the (judgment) should be affirmed." Our right to do so on the petitioner's appeal is clearly established by the opinion of Justice Brandeis in United States v. American Ry. Express Co. (1924), 265 U.S. 425, 435-436.

The material facts are these: Between June 1, 1922 and February 28, 1926 (and prior thereto), the respondent sold storage batteries. The money received from these sales was clearly gross income in the year received. The Government demanded that the respondent pay "excise taxes" on these sales. The respondent protested by letter dated April 28, 1919 (R. 22), and claimed no such payments were due but, under duress did, during the period in question, make payments totalling $825,151.52 (R. 22, 30). Subsequently the respondent brought suit to recover this money and sustained the position it had consistently taken from the time the "excise taxes" were first demanded in 1919. The $1,395,515.35 repaid to the respondent in 1935 represented this principal sum of $825,151.52 plus interest. The respondent did not return any of this amount as income received in 1935 (except for interest earned during that year) but the Commissioner treated the entire payment as 1935 income and made the deficiency assessment on it of $229,805.34 (R. 25-26). The claim for additional 1935 tax was paid under protest and this suit was instituted to recover it, following disallowance of claim for refund. We submit that the 1935 deficiency assessment was erroneous.

For income tax purposes the net income which is taxable is Gross Income less certain designated deductions permitted under the statutes and regulations. The receipts from battery sales are clearly gross income. Permissible

deductions from this include valid excise taxes paid or accrued. On the other hand, an accrued excise tax is not a permissible deduction where the tax is invalid and the taxpayer is contesting it: **Dixie Pine Products Co. v. Commissioner** (1944), 320 U.S. 516. That case held that the taxpayer cannot properly deduct a contested excise tax except in the taxable year in which it is adjudicated to be liable for the payment of the tax. If it is not so adjudicated the deduction can never be made. Consequently, in the present case the $825,151.52 paid by respondent under protest in the years 1922-26 were not proper deductions in those years, and the net income for income tax purposes for those years included this sum of money. If it was taxable income in those years the same sum of money cannot be taxable income again in 1935 merely because it was restored to the respondent's possession in that year. In the *Dixie Pine Products Co.* case the taxpayer kept its books on the accrual basis, and that is also the fact in the present case (R. 37).

After the respondent's protests, that these claimed excise taxes were not owing and that the payments would be illegal exactions, were overruled the respondent made the payments during 1922 to 1926 and claimed them as deductions in its income tax returns for the year in which the payment was made or accrued. The deductions were allowed. It seems clear, under the *Dixie Pine Products Co.* case, supra, that this allowance was an error. The Commissioner should have disallowed the deduction and said to the respondent: "You claim these taxes are illegal exactions. If they are you have merely changed the form of your asset from cash on hand into a valid claim for refund (as proved to be the case). No valid deduction can be taken until your liability, which you dispute, is settled."

The fact the Commissioner did not do this cannot change what was clearly income in 1922 into income in 1935 when all that happened in the latter year is that respondent's asset was changed back from a right to a re-

fund into its original form of cash on hand. The respondent was not responsible for the Commissioner's error. It has taken the consistent position from 1919 down to the present moment that it did not owe the Government any money for excise taxes on parts of automobiles; and from the beginning it has branded the payments it was compelled to make as illegal exactions (R. 22); and it finally proved its contention to be valid. The responsibility for the Commissioner's failure to make timely collections from respondent of the correct amounts due from it for income taxes for the years 1922-26 must be laid squarely on his door-step. There is nothing in this case on which the Government can base any argument that the respondent is estopped from making the point that the refund in 1935 is not income in that year.

The position we take, that a contested and wholly illegal tax collection which is later refunded is income for tax purposes in the year in which the money was originally earned by the taxpayer and not in the year in which the refund is received, is in accord with the previously settled practice in the Treasury Department, as set forth in the Commissioner's rulings, which were followed for many years. It is also in accord with decisions in several Circuit Courts of Appeal: Inland Products Co. v. Blair (CCA 4, 1929), 31 F. (2d) 867; Leach v. Commissioner (CCA 1, 1931), 50 F. (2d) 371, 373; Bergan v. Commissioner (CCA 2, 1935), 80 F. (2d) 89; cf. Cooperstown Corporation v. Commissioner (CCA 3, 1944), 144 F. (2d) 693, 696.

In 1920 in Office Decision 741 the Commissioner held that where a tax is illegally collected and later refunded adjustment should be made in the deduction year as a matter of a correction of a mistake, and that the amount refunded does not constitute income in the year in which the refund is received: Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin No. 3, p. 115 (1920). In a ruling dated July 2, 1932, the Commissioner amended O.D.741 and said:

"A distinction should be made between (1) the ruling published as O. D. 741, supra, and (2) the decisions in the cases of the Chicago, Rock Island & Pacific Railway Co. (13 B. T. A. 988) and the Mixed Claims Commission awards. In the *former case the customs duties were illegally collected and were, therefore, void from the beginning.* It follows that the deductions from gross income were improperly taken and the income tax liability erroneously computed. *When the illegality of these payments was later established the refunds made did not constitute income,* since the original payments were payments made to the collector under mistake. *Readjustment of the returns for the years in which the mistakes were made was the logical method for remedying the situation.* In the latter cases, when the railroad company took deductions for the damage claims and wages and the insurance companies took deductions for the losses, they were strictly within their rights in so doing. The legality of those transactions and the deductions based thereon have never been questioned. There was involved in those cases no element constituting the correction of a mistake.

It is now held that *application of the ruling published as O. D. 741, supra, should be restricted to cases in which collections of customs duties and taxes were illegally or improperly made.* It sometimes happens that duties or taxes are legally or properly collected, but by reason of some subsequent event are refunded. * * * Therefore, legal and proper collections of customs duties and taxes should be distinguished from those illegally or improperly made. Refunds of customs duties or taxes, the collection of which was legally or properly made, should be treated as income for the year in which refunded": Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin XI-2, pp. 33, 34-35, July 2, 1932 (Italics added).

Thus over a period of many years a clear course of administrative practice had been established and uniformly followed in the Treasury Department with respect to refunds of *illegal* tax payments.

Then on December 28, 1934, the Board of Tax Appeals decided Houbigant, Inc. v. Commissioner (1934), 31 B. T. A. 954. The facts were that in 1931 the taxpayer received a refund of a portion of customs duties paid during 1924-29 on goods which had been incorrectly classified. The duties as originally assessed had been included in the 1924-29 tax returns as "increased cost of goods" and had been allowed as such, but not as customs duties. The taxpayer paid one-half of the 1931 refund as attorney's fees and *voluntarily* returned the other one-half in its 1931 income tax return but claimed no deduction for attorney's fees.

After the statute of limitations against any deficiency assessment for the year 1924-29 had run the taxpayer filed a claim for refund of 1931 taxes claiming that the refund of one-half the customs duties had been erroneously included by it in gross income and that the other one-half paid as attorney's fees had been erroneously omitted from the deductions. A refund was paid on this basis. Later the Commissioner reversed his previous action and issued a notice of deficiency.

It will be noted that the taxpayer voluntarily treated the refund as 1931 income and then after the statute had barred the Commissioner from opening up the 1924-29 returns, the taxpayer suddenly changed his position. Further, the deductions in the 1924-29 returns had been allowed for "increased cost of goods." The facts establish a complete estoppel against the taxpayer's belated contention that he erred in returning the 1931 refund as 1931 income.

The Board held that, on these facts, the refund received in 1931 could be treated as income in 1931. The Second Circuit Court of Appeals affirmed without opinion: (1936) 80 F. (2d) 1012; and this Court denied certiorari: (1936) 298 U.S. 669.

On the facts the decision can be sustained on the ground of estoppel, but the statement of the Board that a refund of *illegally* collected taxes is income in the year the refund is received, is not supported by any case it cites and ignores the long settled administrative practice in the Treasury Department up to that time. It also ignores the distinction (emphasized in the Commissioner's 1932 ruling) between refunds of taxes *illegally* collected and refunds caused by subsequent events of taxes *lawfully* collected.

On its facts the *Houbigant* case is clearly distinguishable from the case at bar, and no one can quarrel with the result reached in it. But the Board's dictum is contrary to every prior court decision on the point and the long settled practice in the Treasury Department. It is flatly contrary to O. D. 741 which deals with the very question of the refund of overpaid customs duties, and which is not mentioned in the board's opinion.

The Board's dictum that a refund of taxes should be considered income in the refund year where limitations bar a reassessment of the returns for the earlier year was followed by the Board in Victoria Paper Mills Co. v. Commissioner (1935), 32 B. T. A. 666, which was affirmed without opinion in (CCA 2, 1936) 83 F. (2d) 1022.

In Nash v. Commissioner (1936), 34 B. T. A. 675, the taxpayer took credit in his 1926-31 income tax returns for state income taxes which were later declared invalid and refunded to him in 1932. *The taxpayer treated the refund as income received in 1932 and returned it as such.* After limitations barred a reassessment in the earlier years the taxpayer *changed his position* and filed a claim for refund. Here again the elements of estoppel are present. The Circuit Court of Appeals affirmed in a short opinion containing no discussion but merely citing the Houbigant case, and two other cases not in point: (CCA 7, 1937) 88 F. (2d) 477.

In Bohemian Breweries v. United States (Ct. Cl. 1939), 27 F. Supp. 588, the Court *held* that where the taxpayer had received a refund of excise taxes illegally col-

lected the Commissioner properly disallowed their original deduction in the returns for the year in which they were first paid. The Court *mentioned*, without any citation of authority to support it, "the rule that an amount deducted and allowed from income in a certain year must be included in income when collected or recovered in a subsequent year when the correction of the return and the tax liability in a prior year is barred by the statute of limitations": (p. 592) That is not an accurate statement of any established rule of law with respect to the refund of illegally collected taxes.

In **Union Trust Co. v. Commissioner** (CCA 7, 1940), 111 F. (2d) 60, a refund of estate tax was held to be taxable income of the estate in the year of receipt, because it was too late to reopen the estate's income tax returns for the year in which the estate tax had been deducted. The Court followed its own 1936 decision in the Nash case.

In **Ben Bimberg Co. v. Helvering** (CCA 2, 1942), 126 F. (2d) 412, the Court held that *purchase credits* given to the taxpayer in 1936 by a mill, pursuant to a contract made in 1935 providing for such credit in the event the AAA was declared unconstitutional, were properly treated as gross income in 1936. Although anything Judge Learned Hand says commands respectful consideration he was not *deciding* that refund of an illegal tax is not income in the year it was erroneously claimed as a deduction.

In **Hoboken Land & Improvement Co. v. Commissioner** (1942) 46 B. T. A. 495 the question whether a tax assessed in 1933 and deducted in that year and abated in 1936 is taxable income in the latter year was not a contested issue (46 B. T. A. at p. 503) and in the Circuit Court of Appeals the Court said "That phase of the case is not before the Court on this appeal": (CCA 3, 1943) 138 F. 2d 104, 108.

In **Freihofer Baking Co. v. Commissioner** (CCA 3, 1945) 151 F. 2d 383 the Court held that where the taxpayer paid processing taxes to a mill in 1935 and deducted

them from gross income in 1935 as a part of "costs of goods sold" and received a repayment from the mill in 1936 that repayment was 1936 income. The Court emphasized that the taxpayer was "positively liable in 1935 for the cost of the flour sold to it by the Mills" (p. 386).

The foregoing reviews all the decisions we have found on the point. There are eight cases in all starting with the *Houbigant* case, which is an estoppel case, as is the *Nash* case. In the *Bohemian Brewery*, the *Bimberg*, the *Hoboken Land & Improvement Co.*, and the *Freihofer Baking Co.* cases the question was not decided. In the *Victoria* case there is no opinion of the Circuit Court of Appeals to guide us. In the *Union Trust Co.* case the Court followed its earlier decision in the Nash case. In both cases the taxpayer had *voluntarily claimed* the original deductions which were later refunded.

On February 23, 1937, the Acting Commissioner of Internal Revenue issued a ruling in which he modified the earlier rulings and provided "that in the case of a refund in any year of customs duties or taxes illegally collected which have been taken as deductions in Federal Income Tax returns for a prior year, if the taxable year in which the deduction was taken is closed by the expiration of the period of limitation for the making of an additional assessment of income tax . . . the refund should be treated as income for the taxable year in which it was made": **Treasury Department, Bureau of Internal Revenue, Cumulative Bulletin 1937-1, pp 93-94 Mim. 4564.** The ruling cites the *Houbigant* and *Nash* cases, which are estoppel cases on their facts, but does not confine the ruling to such factual situations.

This is certainly a rule of expediency with a vengeance. It is difficult to see how illegally exacted money which would be 1939 income on June 10, 1945, if refunded on that date, becomes 1945 income when refunded on June 15, 1945, because the limitation period expired on June 12th.

The fortuitous circumstance of the date of limitations cannot be the test of what is income in a given year. Where this purported rule is applied to the refund of money illegally collected and paid under protest it is a pure device to evade the statute of limitations and enable the Commissioner to avoid the consequences of his own failure to make timely disallowance of deductions the taxpayer's own protest warns him are invalid. Furthermore its operation may be most unfair by putting the refund covering several years into a single taxable year governed by much higher tax rates and brackets and thus subject the taxpayer to a far greater tax than if assessed properly in the beginning. *Such a rule can only be supported when applied to a case in which the taxpayer's own conduct has lulled the Commmissioner into taking no action until after action is barred.*

Lurking behind the few opinions on this question is the thought that this so-called rule can be justified as a device of expediency, if not of logic, *to prevent an unjust enrichment of the taxpayer.* But every statute of limitation permits some unjust enrichment and it is doubtful that this is a sound reason. However, it is the only reason by which the rule can possibly be justified *and that reason is not present in the case at bar* because the calculation on page 4 of this brief shows that the Government has received more money from the respondent, without the 1935 deficiency assessment, than it was entitled to collect and that it is the Government, not the respondent, which is unjustly enriched in this case. Consequently there is no possible justification for applying the "rule" to the present facts.

CONCLUSION.

The refunded taxes, which were illegally collected, were not income to the respondent in the year 1935 under sound accounting practices, and their treatment as such was improper. Since the Commissioner was responsible and had adequate opportunity in all pertinent years to make proper adjustment there is no justification in equity or in law for permitting the Commissioner to include in income in a single year all the refunded taxes, thus imposing a penalty on the respondent for which it was in no way responsible.

Secondly, the respondent is entitled to recoupment in any event to the extent of the net amount of the illegally collected excise taxes. The judgment should be affirmed.

Respectfully submitted,

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APPENDIX

McEachern v. Rose (1937), 302 U.S. 56

Analysis of Pleadings, Issues in the Case, Points Argued in the Supreme Court, and Decision of the Supreme Court.

The plaintiff instituted suit in the District Court of the United States for the Northern District of Georgia on September 11, 1934. The petition was in three counts, a separate count being used to set forth the claim to recover overpayments of income taxes for the years 1929, 1930 and 1931, respectively. The suit was in the nature of indebitatus assumpsit. The defendant's answer was filed on March 9, 1935, and set up the following defense to the first count:

"In view of the acts of the Commissioner in relying in good faith upon and accepting plaintiff's sworn tax returns as aforesaid for these four years (1928-31) as correct . . . *it would be unconscionable* for the plaintiff to be allowed any recovery from the defendant as an overpayment of its 1929 income tax . . . and thereby leave the defendant without any existing available remedy to enforce collection from the plaintiff of tax that would be due for the year 1928 under the theory the plaintiff now seeks to advance."

The same language was used in the answer to the second and third counts. The defendant also pleaded that "the plaintiff is estopped to assert and claim" his right to recover the overpayments.

The District Court directed a verdict for the plaintiff but did not file an opinion. The Fifth Circuit Court of Appeals reversed and said "because his action is equitable in its nature and grounds, . . . he may not succeed in it unless he can show that the defendant has money which, ex aequo et bono, the defendant ought to refund": 86 F. 2d 231, 233. The Court relied primarily upon the famous decision of Lord Mansfield in *Moses v. McFarlane* (1760) 2

Burroughs 1005, in which he outlined the nature and scope of an action of indebitatus assumpsit. The Court concluded that such an action "may not be used to obtain money which the plaintiff ought not, in good conscience, to have back."

In the petition for a writ of certiorari, the only reason for granting the writ set forth in the petition was that "the decision of the Circuit Court of Appeals in the case at bar is in conflict, on the question of estoppel, with" cited decisions of the Supreme Court and other Circuit Courts of Appeal. In the Solicitor General's brief in opposition to the writ, the Solicitor General said "The decision of the Circuit Court of Appeals does not rest on estoppel. It rests on recoupment". The petitioner filed a reply memorandum saying, with respect to this, "it may be observed that the opinion nowhere refers to recoupment or otherwise indicates that the Court below relied on the doctrine of recoupment."

Following the granting of a writ of certiorari, the briefs, on the merits of the appeal, were filed. The *Petitioner's Brief* said:

"The petitioner next contends that the issue of recoupment is not open for consideration in this case. A plea of recoupment must allege the existence of a claim, must state the amount of the claim, and must pray that such claim be set up to reduce or wipe out the main cause of action. None of these three essentials is found in any pleading filed by the respondent. The petitioner, therefore, contends that the issue of recoupment is not open" (p. 7).

. . . . . .

"In its pleadings and at the trial of the case in the District Court the respondent relied solely upon the defense of estoppel. . . . *Of particular significance is the fact that nowhere do such pleadings set forth any amount to be recouped.* . . . Certainly the respondent cannot come in at this late date and assert a defense of recoupment on a record where no recoupment was pleaded or raised in any way in the trial court" (pp. 24-25).

In the *Solicitor General's Brief*, in his Summary of Argument, he said:

"This is an action for money had and received, based on equitable principles, in which petitioner must show that respondent wrongfully withholds money equitably due petitioner. Where, as here, the money received by respondent, though received under a technical mistake in procedure under the revenue laws, was no greater than was justly due from petitioner as taxes on the income, no right of recovery in this form of action exists. Stone v. White, 301 U. S. 532. No violation of the statute of limitations results from the application of these equitable principles to this case" (p. 7).

He said further:

"Respondent has not been unjustly enriched at the expense of petitioner. . . . In view of the equitable character of the petitioner's action, he should not be allowed to undo the payments actually made and escape taxation upon the transaction altogether" (p. 9).

"The action here is a suit against the Collector for a refund of income taxes, as was the action in Stone v. White. All that was said there concerning the equitable nature of the proceeding as a successor of the common count in *indebitatus assumpsit* for money had and received, is fully applicable here" (p. 11).

"Petitioner's brief argues that the defense of 'recoupment' is not open under the pleadings. The defense relied upon by the respondent, by whatever name called, was urged in both courts below . . ." (p. 16).

"The defense in question, although in the nature of an equitable recoupment, *is not strict recoupment* but rests upon the necessity that the plaintiff in an action of this kind prove that he is justly and equitably entitled to the money he seeks. Respondent in this case was entitled to show any state of facts which would deny the equity of petitioner's claim, even if the answer went no further than a general plea of non-assumpsit, . . ." (p. 17).

In the *Petitioner's Reply Brief*, in answer to this last statement, the petitioner said that the Georgia practice, which was controlling, "does not recognize the plea of non-assumpsit". He added:

"The amounts paid for 1930 and 1931 would be refundable even if they had been paid and received as taxes for 1928. This follows from the fact . . . the statute of limitations had run. . . . Under Section 607 of the Revenue Act of 1928 any amounts collected as tax after the expiration of the limitation period are deemed overpayments and are refundable". (p. 3).

On page 7 of *Petitioner's Reply Brief*, he referred to "the express commands of Sections 607 and 609 of the Revenue Act of 1928".

These are the only references in the briefs filed on behalf of the parties to Section 607, 608 and 609 of the Revenue Act of 1928. These sections are not even mentioned in the Solicitor General's brief and no analysis of their application or scope is presented.

In addition to the briefs of the parties, the Court also had before it the *Brief of an Amicus Curiae* which contained the following statements:

"Whatever may be the origin of the action to recover taxes overpaid and whatever may be the common law restriction upon an action for money had and received, it is clear that the present suit is an action to recover amounts, *the refund of which is expressly commanded by statute, and that it is only necessary*, as in any other legal action to enforce a statutory right, *to show that the statute requires the payment of money*—not to show that in equity and good conscience plaintiff is entitled to the money. It may be that a common law right would subsist if Congress should take away the statutory right, but so long as the statutory right expressly given by Congress remains, equity is not a matter of importance.

"This Court in Bull v. United States, 295 U. S. 247, 15 A. F. T. R. 1069, truly expressed the nature of the action to recover taxes overpaid. It said that the action is essentially

one by the Government to test the correctness of the summary collection which for reasons of public policy it must be permitted to make before its legal right to the money is tested. It says that the taxpayer in such a suit is not really a plaintiff, but that he is actually a defendant and as such can plead recoupment. This holding was essential to the result reached in the Bull case. If the taxpayer is a defendant in such a suit, where he is clearly entitled to rely upon all his legal defenses, *by what magic could he be converted in the present suit into a plaintiff in an action ex aequo et bono?*" (p. 2).

. . . . . .

"It is respectfully submitted that when consideration is given to all the pronouncements of this Court on the subject of the nature of an action to recover taxes overpaid, and to the cases where the action is admittedly available to recover money which was owed by the taxpayer and which he is not ex aequo et bono entitled to have refunded, as in cases where the sole ground of recovery is that the tax was paid after the statute of limitations had run, this Court will not adhere to any view that an action for recovery of taxes is an action equitable in nature dependent upon a showing that the Government has money to which, in justice and equity, plaintiff is entitled. *On the contrary this Court must hold that the action is legal in nature and dependent only upon a showing that the taxes sued for have been overpaid.*

"That does not mean that an action to recover taxes overpaid is not, like all other legal actions, subject to certain equitable defenses, but it does mean that an action to recover back taxes is subject only to such defenses as would at the time the taxes were collected *have permitted the Government to prevail in an action against the taxpayer.* If the taxpayer has acted in such a way in some other taxable period as to deprive himself of the right to insist that his taxes for the taxable period in question be computed on what would under the statute alone be the correct basis—as where he has misrepresented a fact in an earlier year to

the detriment of the Government and is in the later year held bound by that misrepresentation—he might be denied a refund to which, under the strict provisions of the statute alone, he would be entitled. But recovery would be denied, not upon the ground that the action to recover taxes is equitable or that a taxpayer is not definitely entitled to recover an admitted overpayment of taxes without regard to equities, but upon the ground that, under the facts which he has a right to present, no overpayment is shown to have occurred.

"A holding that, where there has occurred an admitted overpayment of taxes which the Government could not legally have collected, such overpayment may not be recovered back because of some theory of inequity, would lead to most deplorable results. It would be most unfortunate if an officer, clothed with the vast power of summary action which rests with the Commissioner of Internal Revenue, could, by collection of amounts not due or barred by the statute of limitations, place himself in a better position to *keep* such money than he would have been in to *collect* it, had he been compelled to sue. Such a holding would invite lawlessness on the part of officials.

"To permit the Government under such circumstances to retain illegal collections would necessitate the widespread use of injunctions against the collection of taxes" (pp. 5-6).

"It is believed that this Court can search in vain through the revenue statutes for any suggestion that Congress has ever contemplated any such holding except under certain special circumstances expressly provided for by Congress. Congress has generally shown a very wise desire to have taxpayers feel that they can make prompt payment of any taxes claimed from them, or which upon their own computation they feel they may owe, with the full assurance that if the taxes have been overpaid, that is, if the amounts paid are not such as the Commissioner could have legally collected for the year for which paid, the amounts so overpaid will be refunded or credited against unbarred

liabilities which are collectible against the taxpayer" (p. 7).

"Sections 607 and 609 of the Revenue Act of 1928 require absolutely that amounts collected by payment or credit after the statute has run shall constitute an overpayment and expressly direct that 'it shall be refunded', provided only that a claim for refund is filed within time. Congress had already provided in 1924 that suit for refund could be maintained to recover a tax overpaid, although the payment was not made under protest. Congress has thus attempted in every way to see that a taxpayer is not deprived of the benefit even of the statute of limitations because the Government may wrongfully collect or he may ignorantly pay a barred tax, without any regard whatever to whether *ex aequo et bono* the tax was owed. Certainly there is no reason for this Court sanctioning any departure from the sound policy laid down by Congress even if it properly had authority to do so" (p. 8).

From these quotations it will be noted that the whole emphasis in this brief of the *Amicus Curiæ* was that the taxpayer has an absolute statutory right to get back an overpayment and that the Government cannot defeat this right by general notions of unjust enrichment and historical limitations on the scope of indebitatus assumpsit. This argument apparently impressed the Court and was the reason for the reversal of the decision of the Circuit Court of Appeals. In the opinion of the Supreme Court *Mr. Justice Stone* said (302 U.S. 56, 59):

"We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result. But Congress has set limits to the extent to which courts might otherwise go in curtailing *a recovery of overpayments of taxes* because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him" (Italics added).

He referred to Section 607 and Section 609(a) of the Revenue Act of 1928 and said further (p. 60):

"These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation."

From this language of Mr. Justice Stone it seems clear that the Court was holding as a matter of policy, that when the taxpayer makes an overpayment and brings suit to recover it, he is not to be put in a worse position than he would have been in if he had refused to make the payment. The brief of the *Amicus Curiæ* had strongly emphasized the importance of having taxpayers believe they may make overpayments in cases of disputes with a clear understanding that they can obtain a refund later if the Government erred.

We submit that these reasons of policy have no application when applied to the converse situation and it does not follow that Section 608 and Section 609(b) prevent *courts possessing general equity jurisdiction* from applying the doctrine of equitable recoupment in favor of the taxpayer.

The decision of the Supreme Court does not establish that Sections 608 and 609(b) are anything more than administrative provisions to govern the conduct of the Commissioner of Internal Revenue. In fact it does not mention them.

Further, it should not be overlooked that the doctrine of equitable recoupment as such was not raised on the pleadings in this case. This is emphasized in the article "Recoupment in Federal Taxation" (1942), 28 Va. Law Review 577, 594.

In any event we submit that at the most this decision of the Supreme Court does no more than prevent *the Government* from raising the defense of equitable recoupment and that this result is based upon reasons of policy which are not applicable to a taxpayer who seeks to raise the de-

fense of recoupment. Consequently, so far as the taxpayer is concerned, the rule laid down in Bull v. U. S., 295 U. S. 247, is still controlling. This conclusion is strengthened by the fact that the Court cited the Bull case with apparent approval in 1943, six years after the decision in McEachern v. Rose: Commissioner v. Gooch M. & E. Co., 320 U.S. 418, 421.

SUPREME COURT OF THE UNITED STATES

No. 48.—October Term, 1946.

Walter J. Rothensies, Individually and as United States Collector of Internal Revenue for the First District of Pennsylvania, Petitioner, v. The Electric Storage Battery Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 16, 1946.]

Mr. Justice Jackson delivered the opinion of the Court.

This case represents an effort, thus far successful, to obtain advantage by way of recoupment of a claim for tax refund long since barred by the statute of limitations. The facts of this singular situation are not in dispute. From April 1919 to April 1926 the Electric Storage Battery Company paid excise taxes on the sale of storage batteries in the belief, shared by the Government, that such sales were subject to tax. In July of 1926 the company asserted otherwise and filed a refund claim. It asked refund only of that part of the taxes which it had paid between 1922 and 1926. Refund of the taxes paid earlier which the company now seeks to recoup were then barred by the statute of limitations and no claim ever has been filed for their refund and no action ever was begun for their recovery. Suit was brought, however, against the Collector for refund of the taxes paid after July 1922; judgment therefor was obtained in the district court and affirmed by the Circuit Court of Appeals. The Government finally settled by refund of $1,395,515.35, of which $825,151.52 represented tax and the balance interest.

During the years that the refunded excise tax was being collected, the taxpayer deducted it from income before calculation of its income tax, thereby deriving substan-

Electric Storage Battery Co., 327 U. S. 774.

tial benefits. The Commissioner, therefore, treated the refund as income for 1935, the year in which it was received, and because of it assessed additional income and excess profits taxes which with interest thereon totaled $229,805.34. The taxpayer paid the deficiency, filed claim for refund, and after it was rejected sued the Collector. It contended that the refund from the Government was not income to the taxpayer but that if it were so considered taxpayer should be permitted, as against the additional tax caused by its inclusion, to recoup the amount of the barred excise taxes which it had paid between 1919 and 1922. Both courts below correctly held that the refund was properly assessed as income. *Cf. Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281; *Freihofer Baking Co.* v. *Commissioner*, 151 F. (2d) 383. Both have held, however, that the income tax liability for 1935 should be extinguished by recoupment of the 1919 to 1922 excise taxes. The gravity of this holding to the administration of the tax laws led us to grant certiorari. *Rothensies* v. ~~United States Electric Storage Battery Co.~~, 327 U. S. 774.

It is not contended that there is any statutory warrant for allowing barred tax refund claims by way of recoupment or otherwise.[1] Authority for it is said to be found in case law and taxpayer relies chiefly on two decisions of this Court, *Bull* v. *United States*, 295 U. S. 247, and *Stone* v. *White*, 301 U. S. 532. The essence of the doctrine of

[1] Indeed, the applicable provisions of the Revenue Act of 1928 seem to direct a result opposite to that asked by respondent. Section 608 provides that "A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous— (a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; . . ." Section 609 (b) provides, "A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608." 45 Stat. 874, 875. And *cf. McEachern* v. *Rose*, 302 U. S. 56.

recoupment is stated in the *Bull* case: "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." 295 U. S. 247, 262. It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

The application of this general principle to concrete cases in both of the cited decisions is instructive as to the limited scope given to recoupment in tax litigation. In both cases a single transaction constituted the taxable event claimed upon and the one considered in recoupment. In both, the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories, and what was mistakenly paid was recouped against what was correctly due. In *Bull* v. *United States*, the one taxable event was receipt by executors of a sum of money. An effort was made to tax it twice—once under the Income Tax Act as income to the estate after decedent's death and once under the Estate Tax Act as part of decedent's gross estate. This Court held that the amount of the tax collected on a wrong theory should be allowed in recoupment against an assessment under the correct theory.[2] In *Stone* v. *White*, likewise, both the claim and recoupment involved a single taxable event, which was receipt by an estate of income for a period. The trustees had paid the income tax on it but this Court held it was taxable to the beneficiary. Assessment against the beneficiary had meanwhile become barred. Then the trustees sued for a refund, which would inure to the beneficiary. The Court treated the transaction as a whole and allowed recoupment of the tax which the beneficiary should have paid

[2] But the Court emphasized that refund of the incorrect tax was not barred by the statute at the time the Government proceeded for collection of the correct tax.

against the tax the Government should not have collected from the trustees. Whatever may have been said indicating a broader scope to the doctrine of recoupment, these facts are the only ones in which it has been applied by this Court in tax cases.

The Government has argued that allowance of the claim of recoupment involved here would expand the holding in the *Bull* case. The Circuit Court of Appeals agreed that in the *Bull* case "the main claim and recoupment claim were more closely connected than they are here." *Electric Storage Battery Co.* v. *Rothensies*, 152 F. (2d) 521, 524. But the court nevertheless allowed the claim because it considered that this Court had introduced the doctrine of recoupment into tax law and that it was "based on concepts of fairness." 152 F. (2d) 521, 524. It said it saw no reason for narrowly construing the requirement that both claims originate in the same transaction. We think this misapprehends the limitations on the doctrine of recoupment as applied to tax law and it leads us to state more fully reasons for declining to expand the doctrine beyond the facts of the cited cases.

It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.

We have had recent occasion to point out the reason and the character of such limitation statutes. "Statutes of limitation, like the equitable doctrine of laches, in their conclusive effects are designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, mem-

ories have faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Order of Railroad Telegraphers* v. *Railway Express Agency*, 321 U. S. 342, 348–9. "They are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable [avoidable] and unavoidable delay. They have come into the law not through the judicial process but through legislation." *Chase Securities Corp.* v. *Donaldson*, 325 U. S. 304, 314.

As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out.[3] They tempt the equity-minded judge to seek for ways of relief in individual cases.

But if we should approve a doctrine of recoupment of the breadth here applied we would seriously undermine the statute of limitations in tax matters. In many, if not most, cases of asserted deficiency the items which occasion it relate to past years closed by statute, at least as closely as does the item involved here. *Cf. Hall* v. *United States*,

[3] In *American Light & Traction Co.* v. *Harrison*, 142 F. (2d) 639, the court did not allow recoupment to the Government. But judiciously, it said, "Although here a hardship on the Government results from taxpayer's inconsistency, the correlative provisions of this same statute will, in the converse of the instant situation, work an equal hardship on the taxpayer." 142 F. (2d) 639, 643. Whether or not the statute, §§ 608 and 609 of the Revenue Act of 1928, be taken to compel the conclusion we reach in this case, the court's recognition that both parties to taxation are affected impartially, though perhaps harshly, by policy of repose has application here. It may easily be overlooked, when the unfairness of the Government's retaining incorrectly collected monies of respondent is stressed, that the statute of limitations is primarily an instrument of fairness.

43 F. Supp. 130. The same is true of items which form the basis of refund claims. Every assessment of deficiency and each claim for refund would invite a search of the taxpayer's entire tax history for items to recoup. This case provides evidence of the extent to which this would go. When this suit was brought in 1943, the claim pleaded as a recoupment was for taxes collected over twenty years before and for over sixteen years barred by the statute. That claims dead so long can be resurrected under this doctrine, is enough to show its menace to the statute of limitations—at least as to those taxpayers whose affairs by accident or design take such shape that they can avail themselves of recoupment remedies. Moreover, we have held that the Tax Court has no jurisdiction to consider recoupment. *Gooch Milling and Elevator Company* v. *Commissioner*, 320 U. S. 418. Hence, the availability of the remedy would depend on diverting the litigation to the district courts.

We cannot approve such encroachments on the policy of the statute out of consideration for a taxpayer who for many years failed to file or prosecute its refund claim. If there are to be exceptions to the statute of limitations, it is for Congress rather than for the Courts to create and limit them.

The judgment below is

Reversed.

MR. JUSTICE MURPHY is of the opinion, in which MR. JUSTICE BLACK and MR. JUSTICE RUTLEDGE join, that the judgment below should be affirmed. He believes that the claims for refund of the illegal assessments exacted from 1919 to 1922 arise out of the same subject matter as was involved in the Government's demand for additional taxes for 1935, thereby making applicable the rule of *Bull* v. *United States*, 295 U. S. 247.